Estate Planning for the B.C. Farmer

BC
Ministry of Agriculture and Fisheries
1987

87-03423/

BC
F226
D:E782
1987
c.3

ESTATE PLANNING
FOR
THE B.C. FARMER

SECOND EDITION

JANUARY, 1987

A publication prepared for the B.C. Ministry of Agriculture and Fisheries, Farm Management Extension Branch, by Derek J. Fryer, Chartered Accountant, partner in the firm of McKnight Johnson which has offices in Chilliwack, Abbotsford and Mission, B.C.

Canadian Cataloguing in Publication Data
Main entry under title:
Estate planning for the B.C. farmer

First ed. by Derek Fryer.
ISBN 0-7726-0639-0

1. Estate planning - British Columbia - Popular works. 2. Farms - Taxation - Law and legislation - British Columbia - Popular works. I. British Columbia. Farm Management Extension Branch. II. Fryer, D. J. (Derek J.). Estate planning for the B.C. farmer.

KEB515.3.F79 1987 346.71105'2'024631 C87-092075-8

Preface

The term "estate planning" is generally used to describe an orderly three stage process relating to the accumulation, management and eventual disposition or orderly transfer of assets from one generation to the next.

While income tax considerations are of great importance and are dealt with in some detail in this publication, the intention is to put tax matters into context with regard to each of these three stages. Each family member has a stake in the outcome of the plan and the interest or needs of each will change with the passage of time and changing circumstances.

The purpose of this publication is to provide a framework of present concepts and constitute a source of reference useful to farm families in designing an estate plan and in dealing with professionals who will assist in the development and documentation of the plan. Given today's high asset value of farm businesses in British Columbia the need to design and implement a sound estate plan is more pressing than ever before.

Other Ministry publications which may assist farmers in this regard are "Taxation and the B.C. Farmer", "Farm Business Partnerships in B.C.", "Farm Business Corporations in B.C." and "Wills for the B.C. Farmer". From time to time issues relevant to this topic are addressed in the "Farm Business Management Factsheet" series also published by the Economics Branch of the B.C. Ministry of Agriculture and Fisheries.

This publication was prepared by Derek Fryer, Chartered Accountant, a partner in McKnight Johnson. Acknowledgement is also gratefully given to W. Maxwell, R. Newby, and John C. Lee of Baker, Newby & Company, Barristers and Solicitors, Chilliwack for their review of legal matters, to Clare Scott, a partner in McKnight Johnson who edited the material and to Terry Peterson, Supervisor of Farm Business Management programs in the Ministry for his project leadership and review of content through several drafts of this publication.

Director
Farm Management Extension Branch
Victoria, B.C.
V8W 2Z7

January 1987

ESTATE PLANNING FOR THE B.C. FARMER

TABLE OF CONTENTS

Page

Introduction 1

Chapter 1 The Basics of Estate Planning

What is estate planning? 3
What are the benefits? 4
When should you begin to plan? 4
How is an estate plan formulated? 4
Gift tax and succession duties 6

Chapter 2 Will-Planning

Introduction 7
Legal formalities 8
Who should act as executor? 9
Provisions in the will 9
Property not forming part of the estate 11
Wills Variation Act 11
What happens if there is no will? 11

Chapter 3 Significance of Business Arrangements

Introduction 13
Co-ownership - Joint tenancy and tenancy in common 13
Sole proprietorships 14
Partnerships 15
Corporations 15
Trusts 16
Conclusion 17

Table of Contents

Page

Chapter 4 Transfer of the Estate during Lifetime and on Death

Introduction 18

Sales during your lifetime
- Why consider them? 18
- Mortgage or agreement for sale? 19
- Income tax rules applying on the sale of farm property 20
- Claiming of reserves in respect of the unpaid sales price 21
- Planning the sale 21
- Purchase of a replacement farm 22
- Special income tax rules applying to sales to children 22
- Attribution of income to the farmer 25
- Forgiveness of debt 25

Gifts during your lifetime
- Why consider them? 26
- Implications of making gifts 26

Bequests through a will
- General income tax rules 27
- Bequests to a spouse or spouse trust 28
- Bequests to children 29
- Bequests to children through a spouse trust 31

Leases 32

Chapter 5 Tax Planning during Lifetime

Retirement income planning 33
Income from farm assets 34
Registered Retirement Savings Plans 34
Registered Retirement Income Funds 37
Canada Pension Plan 37
Old Age Security 38
Block averaging 38
Forward averaging 39
Capital gains deduction
- General comments............................ 40
- Implications of the capital gains deduction................................ 42

Alternative minimum tax..................... 42
- Outline of the new tax calculation........... 43
- Computation of the minimum tax............... 43

Table of Contents

Page

Other tax deductions and exemptions during retirement 44
Other planning
    Income splitting 45
    Tax shelters off the farm 46

Chapter 6 Use of Corporations in Estate Planning

Introduction 47
Income tax deferral 47
Dealing with non-farming children 48
Other matters to consider
    Principal residence 48
    Capital gains deduction.................... 49
    Potential double tax 50
    Sales tax 51
    Need for professional advice 51

Chapter 7 Life Insurance

Introduction 52
Use of insurance 53
Tax implications 54
Conclusions 54

Chapter 8 Implications of Family Law Reform

Introduction 55
Tax implications of the division of family assets 56
Attribution rules 56
Planning 57

Chapter 9 Administration of the Estate

Introduction 59
Role of the personal representative 60
Role of the solicitor 60
Property that does not become part of the estate 61
Tax liability of the deceased 61
Filing of returns and payment of tax 63
Clearance certificate 64
Accounting records 64

Table of Contents

Page

Chapter 10 Common Estate Planning Problems and their Solutions

Providing for the non-farming children 65
Treating children equally or equitably 68
Rental land 69
Common problems in wills 70

Conclusions 71

Bibliography 72

Appendices 1 Glossary of terms used in estate planning 73

2 Table of intestate succession in British Columbia 81

3 Illustration of the tax deferral that can be obtained by the use of a corporation 82

4 Illustration of the possible use of a corporation in dealing with non-farm children 84

5 Illustration of the income tax rules for the calculation of reserves, where property is sold and part of the sales proceeds remain unpaid 88

6 Illustration of the calculation of the alternative minimum tax................................ 90

Estate plan information.. 92

INTRODUCTION

In the first edition of this publication, written in 1984, the subject matter was introduced by reviewing the script of an imaginary play about a family planning its estate. While the actors were fictitious, the sequence of events was fairly typical of what happened in real-life.

Since that play was written, there have been some important tax changes which will reduce some of the tragic consequences that our imaginary family brought upon themselves by not following through with their estate plans. These changes will not lessen the human side of our family's tragedy; however, so the moral of our story is as valid now as it was two years ago.

The stars of our play are John and Mary Brown who are both aged 57. They have been successful farmers throughout their lives and are now considering retirement in the next two or three years.

All of their assets are tied up in the farm and they have very little insurance. The farm is now being run by their son Bill, who is aged 35 and lives on the property with his wife and two children. He does not have an ownership interest at this time but "understands" that he will inherit the farm one day.

The parents also have two daughters who are married and not involved in the farming business.

In scene one, John and Mary chat about their future retirement while having dinner. It is not a particularly thoughtful discussion - merely a casual conversation about what might happen in the future. They have done this on several occasions in the past and have never involved their children. They have been told by their solicitor and accountant that they should be making an overall estate plan. Bill has also been encouraging them to do this because he would like to know where he stands. John and Mary realize that they should be doing something but always find a reason to put off a decision.

The one point that they seem to agree on is that Bill should acquire the farm because he has put a lot of work into it. The property was inherited from John's parents so they would like to see it continue in the family if possible. However, there remains the question of how they should deal with their daughters. They want to treat all of their children fairly.

John and Mary have prepared a straight-forward will. It provides that after the death of the survivor of them, all of their assets shall be divided equally among their children.

In scene two, John and Mary are killed in an automobile accident and the children suddenly find themselves in the position of co-owners of the farm. Soon there is disagreement as to how Bill might acquire complete ownership of the farm and because of the constant arguments there is a real possibility that there will be permanent damage to the family relationship.

In scene three, the family has split into bitter factions and the farm has been sold. Income taxes have been paid on certain income that arose from the sale and Bill has been forced to move off a farm that has been in his family for three generations.

This scenario is unfortunate, but in real life there can be others which are just as bad or worse. Perhaps the parents do not prepare a will with the result that their property is distributed in accordance with the government's rules rather than in accordance with the parents' wishes. Alternatively, perhaps there is a will, but it is challenged by one or more of the children on the basis that it does not make adequate provision for them. There can be other problems too. Perhaps the parents deal with their farm property in such a manner that they are not able to transfer it to their children on a tax-deferred basis and their family is exposed to a substantial income tax liability.

The desire to avoid these and other estate planning problems is the reason that this book has been written. Hopefully, it will give the reader an insight as to how to approach estate planning.

The commentary is based upon the Income Tax Act as it stood on January 1, 1987. It incorporates a discussion on the new capital gains deduction and the alternative minimum tax. There is also reference to the proposals that were included in the last federal budget dated February 26, 1986 and were passed into law in December 1986.

Throughout the book, the farmer is referred to as a man. This has been done only to make the writing style less cumbersome. The material is, of course, equally applicable to the many women who are involved in farming in British Columbia.

Unfortunately, there are many "technical terms" that must be used when explaining the legal and income tax implications of estate planning. The meaning of these terms is explained in the Glossary in the Appendices of this book.

Derek J. Fryer
Chartered Accountant
McKnight Johnson
Chilliwack, Abbotsford and
Mission, B.C.

January, 1987

CHAPTER 1

THE BASICS OF ESTATE PLANNING

There is a certain reluctance in all of us to deal with the subject of estate planning because it requires us to consider what is going to happen after we die. Death is not a particularly pleasant subject and we prefer not to think about it. Some of this reluctance may disappear if estate planning is thought of in a broader context as having to do with the accumulation and use of property during one's lifetime, as well as its distribution after death. In fact, this is what it is.

Estate planning is particularly important to the farmer because he is part of a very capital-intensive industry. Based on information released recently by one of the Chartered Banks in Canada, it appears that the capital employed in the average farm in Canada increased by over 600% in the ten year period from 1971 to 1981. This rate of growth will no doubt be maintained as farmers continue to mechanize and expand the size of their units so as to operate more efficiently. The size of the farmer's estate, his potential exposure to income tax in respect of his accrued capital gains since 1971 and the fact that substantially all of his net worth is tied up in the farm create special problems for him that can only be dealt with through a well-constructed estate plan.

What is estate planning?

Estate planning deals with all aspects of the accumulation, use and distribution of a person's assets. It therefore entails all of the following:

- accumulating and controlling assets;
- providing adequate retirement income;
- providing for an orderly and equitable distribution of assets during lifetime or on death;
- maintaining sufficient liquidity to pay taxes and other costs at death; and
- minimizing tax.

You have a number of tools at your disposal which you can use to achieve all of the above. For instance, you can:

- prepare a will describing how property is to be distributed after your death (see Chapter 2);
- choose a form of business arrangement that minimizes your tax liability and facilitates the transfer of your property to your beneficiaries (see Chapters 3 and 6);
- transfer property during your lifetime or on death and use trusts to hold property for your wife or child (see Chapter 4);
- plan your retirement income (see Chapter 5); and

- provide liquidity in your estate with the use of life insurance (see Chapter 7).

What are the benefits?

The time and effort spent on an estate plan is usually well-rewarded in terms of the savings in taxes, estate management costs and property transfer procedures. Equally important, however, is the peace of mind enjoyed by you and your family in the knowledge that the plan has been well-thought-out and is fair to all.

When should you begin to plan?

You should give some thought to estate planning as soon as you begin to accumulate assets. While you are single and relatively young, your planning will perhaps be restricted to the safeguarding of valuable assets (such as storing of valuable documents in a safety deposit box) and the preparation of a will setting out what should happen to your property in the event of your sudden death.

After you marry and start a family the scope of your planning will broaden. You will change the beneficiaries in your will and perhaps name a person who would act as guardian to your children if you and your wife should die suddenly. Your business affairs will probably become more substantial and you will want to assess whether any alternative form of organization would be beneficial. Perhaps you will want to form a partnership with your wife. Your debts will probably be more substantial and you will want to reassess the extent of your insurance coverage.

Later on in life your estate plan will broaden even further because you will then have to decide how to bring your children into the business. Ultimately, you will have to consider your retirement plans and the disposition of your property. Plans may have to be changed periodically in response to external factors such as new government legislation.

It can be seen, therefore, that an estate plan is not something that is made and then forgotten. It is something that evolves throughout the middle years of a person's life and requires a periodic check-up in response to his changing circumstances.

How is an estate plan formulated?

Your planning in the early years will probably centre around the managing of your farm and the earning of sufficient income to support your family. In later years, however, you will have different concerns such as:

- will any of your children want to take over the farm?
- if yes, how should it be transferred to them and what would the tax consequences be?
- how can the transfer be structured so that you receive sufficient retirement capital?
- how are your non-farming children to be provided for?

- do you have sufficient liquid assets?

The first step in dealing with these concerns is for you to develop some estate planning objectives concerning the disposition of your property. This will not necessarily be easy. It is important for you to discuss the matter openly with your family, perhaps over a considerable length of time. The decisions will not be made "overnight" - at least the correct ones will not be.

You will have to wrestle with the questions of whether or not the farm can support the number of children who are interested in carrying it on and whether the equitable distribution of property among your children should be an equal one. Often it will not be. Sometimes you will arrive at conflicting objectives. You may, for instance, want to transfer your farm intact to your son but, because you also want to treat your other five children equitably and have few non-farming assets, you may be forced into breaking up the family farm.

If you intend to bring one or more of your children into the business you will have to recognize that special arrangements will have to be made in the early years. The child's contribution of capital may be small yet his income requirements may be quite high because of the costs he must incur in raising a young family. A profit split based solely on your respective contributions of capital and labour may not meet the child's needs and may cause him to become discouraged.

One of your estate planning objectives should be to ensure that your retirement needs are provided for. This is an aspect that is often not given the attention that it deserves. You will have to consider a number of questions, including the following:

- is it likely that the farm will be transferred to your children during your lifetime and, if so, how much retirement capital could it provide?
- will it be necessary to move off the farm?
- what non-farm income will you receive during retirement (pensions, etc.)?
- what will your other income requirements be?

After establishing your objectives, you should compile an inventory of your assets and then become familiar with some of the techniques for estate planning and the income tax rules applying on the disposition of farm property. You should do this by talking to your friends and neighbours and to the local Regional Farm Economist from the Ministry of Agriculture and Fisheries. You might also review a publication on estate planning such as this one and the other publications issued by the Ministry of Agriculture and Fisheries entitled "Wills for B.C. Farmers"; "Farm Business Partnerships in British Columbia"; "Farm Business Corporations in British Columbia"; and "Taxation and the B.C. Farmer". Finally, you should seek professional advice from your solicitor, qualified accountant and insurance agent.

After a plan is developed in draft form by your professional advisor, you should discuss it with your family. It is important that all members of your family know where they stand and believe that they have been fairly treated. Time spent at this stage can save much anguish after your death. It can also avoid the possibility of the plan being contested under the Wills Variation Act.

Your accountant will naturally be concerned about minimizing your tax liability, but it must be recognized that tax is not the most important consideration. You and your wife must feel comfortable with the plan recommended to you and it must conform to your ideas on how you should deal with your children.

The estate plan should be flexible. It should, for instance, take into account that your children may change their personal goals and career paths. You should not take irrevocable steps until you are certain that your children have decided what they want to do with their lives.

Your wife should be acquainted with all aspects of the business. She should be aware of the location of the important documents and records so that if you were to die suddenly she would know what has to be done.

An important ingredient of the estate plan will be the maintenance of adequate financial records. You should maintain a record of your major assets, insurance policies, bank accounts, etc. and should keep them in a safe place together with your other valuable papers. The schedules in the Appendices of this publication may be helpful to you in this respect.

Gift tax and succession duties

Farmers in British Columbia have to consider the effect of income taxes on their estate plans but, fortunately, they do not also have to wrestle with gift taxes and succession duties. These taxes were abolished in British Columbia in January 1977 and have now been eliminated in all other provinces except Quebec. Nowadays, therefore, you need not be concerned about the possibility of a gift tax if you should transfer property or cash to a member of your family.

CHAPTER 2

WILL-PLANNING

Introduction

One of the most important documents that you execute during your lifetime is your will. Ideally, it is just one of the key elements in your overall estate plan but in some situations it represents the only estate planning that is done. It may have far-reaching effects on your family and business partners so it should be given a lot of consideration. A solicitor should always prepare the document in order to avoid potential problems.

Will-planning is important both for you and your wife. Very often the farm is owned by you jointly and your respective interests in the property pass to the survivor on the death of the first spouse.

The will is a legally enforceable document that can be altered or revoked during your lifetime, so long as you have testamentary capacity, and becomes effective only on your death. It describes your wishes regarding the distribution of your property and the appointment of executors. It may also deal with other matters such as the appointment of trustees to hold property in trust for your surviving spouse and for children and the appointment of guardians for your children.

A person loses his testamentary capacity when he is no longer able to understand the nature and effect of particular documents. This might happen for instance, if he were to have a stroke. Because there is always the possibility of this occurring without warning it is important that will-planning be updated regularly.

All farmers should prepare a will to ensure that their property is distributed in an orderly manner to their family and friends, in accordance with their wishes. If they fail to prepare one, their assets can only be dealt with in accordance with the provisions of the Estate Administration Act (see later discussion). This can result in additional worry for the farmer's family, a possible delay in the distribution of his estate and the exclusion of some persons from sharing in his assets that he would have wanted to benefit. In some instances, there may even be a loss of an income tax "rollover" on the transfer of property to a child although this possibility is generally less serious now that we have the new $500,000 capital gains deduction (see Chapter 5).

In planning your will, you should take into account many factors including the provisions of buy-sell agreements entered into with your business partners, the income tax rules applying on death, the amount of liquid assets in your estate, the manner in which you hold your business assets and the provisions of any marriage agreement. Because these considerations are complicated and they change periodically, you should get into the habit of obtaining professional advice and reviewing your will-planning every three or four years. There should always be a review after the following:

- a major change in business arrangements (e.g. formation of a company or partnership);
- a beneficiary emigrates from Canada;
- major changes in the form or mix of assets;
- major succession duty or income tax changes;
- birth or death of a child or grandchild;
- divorce; or
- death of an executor, spouse or other named beneficiary.

In deciding the terms of your will, you should thoroughly discuss your estate plans with your family. There should be no surprises after your death and your family should be prepared for what is to happen at that point. This discussion can take a considerable length of time and may be assisted by the involvement of professionals such as the family solicitor and accountant, an insurance agent and perhaps the local farm economist from the Ministry of Agriculture and Fisheries.

After the will is completed and signed, you should leave the original with your solicitor for safe-keeping and should keep a copy for your own records. It may be appropriate to also provide a copy to your accountant and executor.

Legal formalities

The formalities governing the making of a conventional will are contained in the Wills Act of British Columbia. This Act provides that the document must be in writing and must be signed by the person making it (the testator) or by some other person in his presence and under his instructions. The testator should sign his will in the presence of two or more witnesses who should be over the age of majority and should not be beneficiaries named in the will, nor the spouses of those beneficiaries. This latter point is extremely important. If bequests are made to the witnesses of a will, or to their spouses, they will be forfeited and the property will simply form part of the residue of the deceased's estate.

If there is more than one will, the last one over-rides the earlier versions. For this reason, it is important that the will be dated.

Generally, a person must be nineteen years of age or older before he can make a will although a married infant (a person under age nineteen) or a member of the Canadian forces can prepare one irrespective of his age. The person must have the mental capacity to prepare the will and must not be forced or coerced into it.

A will may be revoked by making a new one, by destroying or revoking an existing one or by the marriage of the testator. (A divorce will not revoke a will but it will have the effect of cancelling transfers of property to the ex-spouse and the appointment of him or her as executor or trustee.) A testator need not necessarily make a new will each time he wants to change it. He may be able to make the change by simply attaching a "codicil".

If a person prepares or updates his will shortly before his marriage, he should record in the document that it is being prepared or updated in contemplation of marriage. This evidences that he was aware of his upcoming marriage at the time the will was prepared and the marriage itself will not then have the effect of revoking it.

Who should act as executor?

You will generally want to have your wife and/or your children act as executors. The decision as to who should be involved will depend on the complexity of your business arrangements and the ability of your wife and children to deal with them.

If the will establishes a trust for your wife under which income from the farm passes to her during her lifetime and the farm property passes to your children on her death, it might not be a good idea for the wife to act as the sole executor. One or more of the children might also be appointed so that there is a proper balancing of the interests of your wife and children. If your will empowers the executors to augment your wife's income by selling assets of the trust, it is usually preferable to also have independent executors so that your children are not placed in the awkward position of trying to decide whether a sale should be made.

In some situations, it may be appropriate to have a friend or business associate act as an executor. You should ensure, however, that the business associate is not put in a position of conflict. This might happen if farm assets are to be sold by the estate and the business associate might be one of the buyers.

Some farmers have named their solicitor or accountant to act as one of the executors. These persons may be good choices if they have a detailed knowledge of the testator's affairs and beneficiaries, and can afford to spend the appropriate amount of time on estate administration. Often, their other commitments prevent them from doing this and the farmer is better off to retain these individuals in their professional capacities rather than as executors.

A trust company may be useful in situations where you have extensive business interests or a trust is to be created that will exist for a long time. It can provide a full service administration package that can rarely be equalled elsewhere. However, the trust company will not always have an office in the area in which you live and this can complicate the administration of the estate. The trust company may also be more costly.

Provisions in the will

The testator should specify the manner in which his estate is to be distributed. The distribution may be in the form of a specific bequest, a general bequest or a share of the residue of the estate.

A specific bequest is made where a specific property such as an interest in a particular corporation or a specific parcel of land is left to a beneficiary. If the particular property is sold before the testator's death, the beneficiary may lose his inheritance unless he also shares in the residue of the estate.

A general bequest refers only to a sum of money rather than to a particular property. If the testator's debts exceed the residue of his estate, the excess will be applied on a pro-rata basis against these bequests.

The testator will usually specify what is to happen to his debts. They may be assumed by one of the beneficiaries or be paid out of the residue of the estate.

Property passing to the testator's spouse may be transferred directly to her or to a trust for her benefit. Use of a trust will ensure that the future entitlement of their children cannot be affected by a second marriage of the surviving spouse. The testator may also use a trust to hold property for infant children.

There is usually a provision setting out what should happen in the event that the testator and his spouse are killed in a common accident. If there is no such provision, the younger of the two is deemed to survive the other and the distribution of the two estates is processed accordingly. Sometimes the will also provides that the bequest to a spouse shall not take place unless he or she survives the testator by at least 30 days.

The testator may consider giving his children the right to acquire certain farm property from his estate at a percentage of its fair market value. As a result of recent amendments to the Income Tax Act, this will generally not result in tax problems (see Chapter 4).

As a result of recent amendments to the Income Tax Act, the personal representatives of a deceased person are able to select the values at which certain farming assets are transferred to the deceased's children. The values selected will have an impact on the tax payable by the estate and will determine the cost of the property to the children who receive it. It is important that the will give the personal representatives the power to make this selection for income tax purposes. Furthermore, consideration should be given to providing instructions to the personal representatives as to the manner in which they should make their selection. In most situations, the testator should instruct the personal representative to select the highest transfer values that will not result in tax being paid by the estate.

If certain assets are to be distributed "in specie", the testator should ensure that the will gives the executor the power to do this.

Property not forming part of the estate

Property held in a joint-tenancy arrangement (see Chapter 3), together with the proceeds of insurance policies and registered retirement savings plans for which there are named beneficiaries, do not form part of a deceased's estate and accordingly, are not affected by the terms of his will. These assets pass directly to the surviving joint tenants or to the named beneficiaries, as the case may be, and are not available to the deceased's creditors. You should check your old insurance policies and registered retirement savings plans to ensure that the "beneficiary designation" is still appropriate.

Because of provisions in the Income Tax Act, you will generally want to designate your wife as the named beneficiary of your registered retirement savings plan. This is discussed in Chapter 5.

Wills Variation Act

You should be aware that even where you provide for the disposition of your property in a properly-drawn will, the Wills Variation Act in British Columbia may enable your wishes to be varied or set aside by a court if it determines that you have not made adequate provision for your wife and children. Some provision is not necessarily adequate provision. This possibility is sometimes of concern to a farmer because his assets are not always divided equally amongst his children. In some situations, the desire to keep the farm intact and to treat all children equitably, not necessarily equally, means that the inheritance of some children is larger than others.

Disputes can be avoided if you discuss your estate plans with your family and obtain their approval. Where one of the children appears to be treated on a more favourable basis, perhaps because of previous contributions to the farm for which he has not been paid, it is probably advisable for you to include your reasoning in your will. Then, if the matter is contested after your death, the court will be able to take this reasoning into account.

If one or more children are to receive more than their pro-rata share of the estate, it may be advisable for you to arrange for the transfer of the extra share during your lifetime. In this manner, you might avoid potential problems under the Wills Variation Act. You may gain other benefits as well because, generally speaking, the transfer of farm property during one's lifetime can be an excellent method of distributing the estate. Obviously, this is a matter that you should discuss with your solicitor, and perhaps your accountant, when preparing your estate plan.

What happens if there is no will?

If a person dies without making a will, the intestacy rules in the Estate

Administration Act in British Columbia come into effect. These rules state that no one has authority to deal with the deceased's assets until an administrator is appointed by the court. This can be an expensive and cumbersome procedure.

The manner of distributing an intestate's assets will depend on the relationship of the persons who survive the deceased. If the intestate leaves a spouse and children, the home and furnishings and the first $65,000 of the other assets pass to the spouse and the remainder is allocated between the spouse and children. The spouse receives one-half of the remainder where there is only one child and one-third where there is more than one child. If the intestate is survived only by his children, the entire estate is divided between them on an equal basis.

Attached as an appendix to this publication is a schedule describing the manner in which assets are distributed on an intestacy in different situations.

As will be discussed in Chapter 4, there are rules in the Income Tax Act that allow certain farm property to be distributed on death from one generation to the next, on a tax-deferred basis (called a "rollover"). These rules apply only where the property vests indefeasibly in the beneficiary within a certain time period following the date of death. (The term "indefeasibly" means, in effect, that the right of ownership cannot be defeated by a future event.)

Where there is a will, the rollover will generally be assured because the property passing to the deceased's children is deemed to vest in them on death. Where, however, there is no will, the situation is not as clear and the circumstances of each case will determine whether the rollover applies.

CHAPTER 3

SIGNIFICANCE OF BUSINESS ARRANGEMENTS

Introduction

The manner in which you organize your business interests can have a significant impact on your estate plan. Your land, for instance, might be owned outright or might be co-owned in the form of a joint tenancy or tenancy in common. These alternate forms of ownership can affect your ability to deal with your land through your will.

Your business might be carried on by a proprietorship, partnership, corporation or trust. These different arrangements can have a substantial impact on the manner in which you operate your business, the income taxes that you will pay during your lifetime and the form in which your children will receive their inheritance after your death.

Co-ownership - Joint tenancy and tenancy in common

A joint tenancy is an arrangement under which two or more persons hold an undivided interest in property. The characteristic that distinguishes it from other forms of co-ownership is the inability of the joint tenant to dispose of his interest in the property through his will unless he severs the joint tenancy before his death. On death, the joint tenant's interest automatically passes to the other joint tenants.

This "survivorship" characteristic does not prevent the joint tenant from dealing with his interest in the property during his lifetime. He can transfer this interest to strangers, or to his joint tenants, in the same manner that he deals with other interests in property.

A farmer and his wife will often hold property as joint tenants because they intend that their respective interests shall pass to the survivor of them on their deaths. However, business partners will generally not hold their property interests in this manner because they will want to control the distribution of their property after their death.

A tenancy in common is also an arrangement under which two or more persons hold an undivided interest in property. As with a joint tenancy, each co-owner has an equal right to possession of the property because the property has not been divided in a specific way. Unlike a joint tenancy, however, the ownership interest of a co-owner under a tenancy in common need not be equal to that of his co-owners. For instance, a tenant under a tenancy in common arrangement could hold a 90% interest in a particular property and his co-owners could hold the remaining 10%.

Property owned under a tenancy in common arrangement does not pass to the co-owners on the death of the tenant. It falls into the tenant's estate and is disposed of in accordance with his will, just like any other property.

Land owned by a partnership should be registered jointly in the names of the partners. Ordinarily, it would be held in the form of a tenancy in common and not a joint tenancy.

If a person, owning a property outright, transfers an interest in that property to another person so that he then holds the property as a co-owner, or if he transfers part or all of his co-ownership interest to another person, he will be treated as having disposed of the property for income tax purposes. The property will be deemed to have been disposed of at fair market value unless one of the rollover rules apply (see Chapter 4). You should, therefore, be careful if you are considering a change in the manner in which your property is registered.

Sole Proprietorships

If you are a sole proprietor you will usually own all of your farming assets directly, or jointly with your wife, and you are able to transfer them during your lifetime or through your will. In some situations, the farm is co-owned in a joint tenancy arrangement and will automatically pass to your wife on your death.

The transfer of a sole proprietorship to the next generation may be time-consuming and cumbersome because each asset will have to be identified and dealt with. However, for many farmers, the simplicity and flexibility that the sole proprietorship offers during their lifetimes more than compensates for this problem. Moreover, there is an intangible benefit in that the direct ownership of the farm is more in keeping with their emotional attachment to the land.

The sole proprietorship allows you to operate your business in a reasonably tax-effective manner. This is important, because the minimization of tax is an integral part of any estate plan. Admittedly, as a proprietor in British Columbia, you are subject to tax on your farm profits at marginal rates which vary from nil to approximately 50% and, in certain circumstances, you are subject to the new alternative minimum tax. However, there are a number of offsetting advantages. You can, for instance, use block averaging and forward averaging, you can claim the new capital gains deduction in respect of the capital gains arising from the sale of your farm property, you can claim the principal residence exemption on the sale of your farm, you can issue a small business bond if you are in financial difficulty and you can offset your farming losses against other income without restriction provided you are considered to be a full-time farmer and are not caught by the restricted farm loss rules. You can also offset business or property losses against farming income.

If you wish to review these aspects further you should read "Taxation and the B.C. Farmer" published by the Ministry of Agriculture and Fisheries in British Columbia.

The sole proprietorship gives you considerable flexibility in distributing your farming assets to your children in a tax-effective manner. There are also extensive "rollovers" available in respect of farm property transferred to a spouse or to a spouse trust and to property transferred from a spouse trust to a child. These are discussed in Chapter 4.

Partnerships

If you are a partner in a farming partnership, you are in a different position than the sole proprietor. Even though certain partnership assets such as land may be registered jointly in the name of you and your partners, and it will be necessary to change this registration when you die or dispose of your interest in the partnership, the Income Tax Act does not consider you to be the owner of the individual assets in the partnership. Rather, the partnership is considered to own them and you are considered to own a "partnership interest" in much the same manner as you might own shares in a corporation. When you die, you are deemed to have disposed of this partnership interest and not your interest in the individual assets.

If you enter into a partnership you should remember that you become jointly and severally liable for all of the partnerships debts. Accordingly, you should choose your business partners carefully.

In terms of your ongoing exposure to income tax, the partner in a farm partnership is in much the same position as the sole proprietor. If you wish to review the tax rules applying to partnerships you should review "Farm Business Partnerships in British Columbia", a publication issued by the Ministry of Agriculture and Fisheries in British Columbia.

Because a partnership is treated for tax purposes as being an entity that is separate from its partners, care must be taken in transferring assets to a partnership or receiving assets from it. Generally, these transfers are deemed to take place at fair market value unless special elections are filed with Revenue Canada within a prescribed time limit. This area is discussed in "Farm Business Partnerships in British Columbia", referred to earlier.

The partner who has an interest in a farming partnership has considerable flexibility in distributing his interest to his children and his wife in a tax-effective manner. This is discussed in Chapter 4. He has an even greater ability than the sole proprietor to take advantage of the new capital gains deduction. This is discussed in Chapter 5.

Corporations

Corporations are treated under corporate and income tax law as being entities which are separate and distinct from their shareholders. If you transfer your interest in a corporation to your wife or child, it is only necessary to amend the corporation's share records. The transfer is therefore extremely easy. The corporation can provide continuity for the farming operations. The corporation might be passed from one generation to the next but the operation of the farm will continue unaffected.

If you incorporate your farm you will no longer be able to block average. Furthermore, you will have to pay increased attention to the proper segregation of your personal and business funds. Because the corporation is a separate entity for tax purposes and there are rules in the Income Tax Act that restrict it from making loans or advances to its shareholders, there will have to be a careful accounting of your draws and personal expenses, and these amounts will have to be repaid or covered off by the payment of a salary or dividend.

Most farm corporations are taxed at the rate of only 23% on the first $200,000 of taxable farm income each year. This rate is scheduled to reduce to 22% on July 1, 1987 and 21% on July 1, 1988 (excluding surtax). This and other aspects of the taxation of corporations and their shareholders are discussed in "Farm Business Corporations in British Columbia", another publication of the Ministry of Agriculture and Fisheries.

One point to be noted with respect to the use of corporations is that the corporation is not able to claim the capital gains deduction in respect of the gains arising from the disposition of its property. However, you, as shareholder, are sometimes able to take advantage of the deduction by selling shares of your corporation. Alternatively you are able to leave your land and buildings outside of the corporation and take advantage of the deduction by selling this property directly.

As a shareholder of a farm corporation, you have considerable flexibility in distributing your share interest to your children or wife on a tax-deferred basis. This is discussed in Chapter 4.

Trusts

Farmers do not often use a trust arrangement because they prefer to keep their affairs uncomplicated and pass absolute ownership of their farm to their wife or children. There will be situations, however, where a farmer decides to transfer his farm to his children (either during his lifetime or upon his death), but wants to ensure that the income from the farm is paid to his wife during the remainder of her life. This can be achieved by establishing a spouse trust. The effect of the trust will be that his children will not acquire ownership of the farm until after the death of the surviving spouse. At the same time, the spouse will not be able to dispose of the farm in her lifetime or in her will and the children cannot be cut out of his estate if his spouse should remarry after his death.

You may want to consider the use of a trust in the event that you should die unexpectedly and property should pass from your estate to a child who has not attained the age of majority.

A farmer may inherit a trust arrangement. One of his parents may have placed farm property in a trust with the stipulation that it should remain there until both parents die. The farmer may perhaps manage the farm and be paid for his work but during the lifetime of his surviving parent, the overall control of the farm will remain with the trustee of the trust.

The farmer is the capital beneficiary of the trust because at some point he will acquire ownership of the farm. The surviving parent is the income beneficiary.

Property passing to a trust becomes the property of the trustee. The terms of the trust agreement will determine the manner in which he is able to deal with it.

A trust determines its income for tax purposes in much the same manner as any other person. The major exception is that it can deduct the income that is paid or payable to its beneficiaries. The amount deducted is included in the income of the beneficiaries. In certain types of trusts, the trustee and the beneficiaries can file a special income tax election (a preferred beneficiary election) which has the effect of deeming the income accumulating in the trust to be the income of the beneficiaries, even though it is not paid or payable to them. This income is then taxed in the beneficiaries' hands and not in the trust.

A trust created through a will (called a testamentary trust) will generally pay tax on its income at the marginal rates applying to individuals. A trust created by an individual during his lifetime will generally pay tax at a flat rate of approximately 50%.

Property passing into or out of a trust may be treated for income tax purposes as having been disposed of at fair market value. There will be deemed dispositions in other situations as well. Because of this, you must seek expert professional advice if you contemplate using a trust arrangement.

The trust itself is generally not able to claim the capital gains deduction in respect of capital gains arising from the disposition of its property. An exception is made in respect of capital gains arising in a spouse trust (see Glossary) in the year in which the spouse dies. In situations where the capital gains of a trust are taxed in the hands of the beneficiaries, the capital gains deduction will be available to the beneficiaries in respect of these gains.

In certain circumstances, you are able to use a trust arrangement to transfer farming assets to your wife and then to your children on a tax-deferred basis. This is discussed in Chapter 4.

Conclusion

As mentioned in the introduction, the manner in which you hold your business assets can have a significant impact on your estate plan. Before changing the existing arrangements you should obtain advice from your accountant and solicitor in order to avoid potential tax and legal problems.

CHAPTER 4

TRANSFER OF THE ESTATE DURING LIFETIME AND ON DEATH

Introduction

The transfer of your estate is the culmination of your estate plan. If the plan has been well thought-out, and circumstances permit, you will have accumulated sufficient capital for your retirement, you will have provided adequately for your wife, you will have dealt equitably with your children and you will have arranged for a tax-effective transfer of your farm to the next generation. The manner in which you accomplish this may be different than other families. No two situations are alike because there are always personal requirements, relationships and feelings that are unique to the family concerned.

The techniques you will utilize in transferring your estate are those discussed in this chapter. The manner in which you use them will be determined by your estate planning objectives.

Because of the capital intensive nature of the farmer's business and the significant increases in value that have occurred since 1971, there has always been considerable concern about the impact of taxes on the manner in which the estate is transferred. This concern has been lessened significantly by the introduction of the lifetime capital gains deduction (see discussion in Chapter 5) and the increased ability to select the values at which qualifying farm property is transferred to children on the death of a farmer. The recent developments are not all favourable, however, because the government has now introduced a minimum tax calculation (see discussion in Chapter 5) which can impose an additional tax on the farmer if he realizes a substantial capital gain when he retires or dies.

The recent developments mean that you now have a greater ability to achieve your estate planning objectives without the payment of a significant tax. Whatever plans are put into effect they should be designed so as to make maximum use of the lifetime capital gains deduction.

SALES DURING YOUR LIFETIME

Why consider them?

You may consider the sale of your farm property for different reasons. For instance, your children may not be interested in farming and you may therefore be obliged to sell your farm assets to a person outside the family when you retire. Alternatively, you may wish to sell all or a part of your farm to your "farming children" so as to provide capital that you can use in your retirement and a pool of non-farming assets that you can leave to your other children who will not be involved in the farm.

If the sale results in the payment of income taxes, and there are alternatives that would enable you to avoid this tax and still achieve your financial objectives, your accountant may try to persuade you to change your mind. You should remember, however, that the minimization of tax is not always the most important consideration. An estate plan should not be followed unless you are comfortable with it and it conforms to your beliefs as to how a parent should deal with his children.

As we will discuss later, the Income Tax Act permits you to sell your farm assets to your children at less than fair market value. If you decide to do this you should consider carefully whether the proposed sale proceeds will provide you with sufficient retirement capital. You should take into account the possible impact of inflation and the pensions and other income that you will receive during your retirement.

In the sale document you may want to provide that if your farming child should sell the farm shortly after acquiring it, there should be some adjustment to the original purchase price to prevent the child from realizing an unreasonable profit.

A sale to your children during your lifetime is the preferred arrangement because it ensures that the property reaches the intended beneficiary. Arrangements can be made for you and your wife to remain on the farm and assist in the running of it so that the transition from active farming to retirement is a gradual one.

Mortgage or agreement for sale?

If you sell your farm and take back debt on the transaction, you can structure the arrangement as an agreement for sale or secure the amount owing to you by having the purchaser grant a mortgage. If the contract is structured as an agreement for sale, title to the property remains with you until the debt is repaid. If a mortgage is used, title passes to the purchaser and you take back the mortgage as evidence of the debt. If there is a default under the agreement for sale or mortgage, you have the right to commence court action for the cancellation of the agreement for sale or for foreclosure under the mortgage.

The agreement for sale or mortgage will set out the repayment terms of the debt and the interest rate that will apply. If you sell to a child you will have to take into account the ability of the farm to generate the payments that are provided for in the agreement as well as your own needs. If the child will have difficulty in making the debt repayments, you may decide to accept a low interest rate or may even agree to charge no interest in the first few years of the agreement. Quite often, there will be an acceleration clause that will require the agreement for sale or mortgage to be repaid if the child sells the property.

Income tax rules applying on sale of farm property

The tax arising on the sale of farm property will depend on the nature of the asset. If the property is a capital asset such as land, buildings, equipment, shares in a farm corporation or an interest in a farm partnership, there will be a capital gain to the extent that the sale proceeds exceed the total of the "adjusted cost base" of the property (see Glossary) and the costs of disposition. One-half of the capital gain (called the taxable capital gain) is included in your income.

An important development in the estate planning area is your ability to claim a capital gains deduction of up to $250,000 to offset taxable capital gains included in income. This deduction is available if the sale occurs in 1985 or future years. Details relating to the deduction are summarized in Chapter 5, commencing on page 40.

If the property is buildings, machinery or equipment depreciated for income tax purposes on the reducing balance basis, the depreciation claimed in previous years will be included in your income in the year of sale (i.e. "recaptured") to the extent that the lower of the sale proceeds and the original cost exceeds the undepreciated capital cost. If the asset was acquired before 1972 and depreciated for income tax purposes on the straight-line basis there is no recapture of prior years' depreciation. If you take back debt on the sale, no portion of the recaptured depreciation is deferred for income tax purposes.

Where the sale proceeds of property depreciated on the reducing balance basis in a particular tax class are less than the undepreciated capital cost of the property, and you have no other property of that class, the excess will ordinarily be deductible from your income as a "terminal loss". This deduction will likely be restricted, however, if the loss relates to a building and the land on which it is situated is sold at a profit.

If the property is quota, or any other government right or intangible asset, and you dispose of all such assets, one-half of the proceeds are taken into income. You are then able to deduct from income the balance of your undepreciated expenditures for such assets. This balance (called the cumulative eligible capital) will represent one-half of the original expenditures after 1971, less amounts written off for income tax purposes in previous years and less one-half of the proceeds of previous sales after 1972. If some of the quota sold was owned at December 31, 1971 (V-day), the formula for calculating the gain on sale will take the V-day value of such quota into account.

The Canadian courts have determined that under current income tax law, there is no inclusion in income in respect of the sale of quota or other intangibles until the sales proceeds become receivable.

If the property is livestock or feed and you use the accrual basis of accounting for tax purposes, the sale proceeds will be included in your income in the year of sale whether or not you receive the full sale proceeds in that year. If you use the cash basis of accounting for tax purposes, you only have to report as income in the year of sale the actual proceeds you receive during the year. Proceeds not reported in the year of sale are reported in the year they are actually received.

If you sell all of your livestock, you will be able to write off the balance of your basic herd, if any, and, if you are on the cash basis of accounting, you will also be able to deduct the livestock adjustment that you included in your income in the year preceding the year of sale.

Claiming of reserves in respect of the unpaid sales price

You may claim a reserve in respect of the unpaid sale proceeds when computing the capital gain arising from the sale of assets such as land, buildings, shares of farm corporations, partnership interests, etc. Originally, this reserve was intended to spread the tax liability over the period in which the unpaid sales proceeds were collected. However, as a result of rules introduced into the Income Tax Act in 1981, the reserve cannot be claimed for a period in excess of ten years (five years if the transferred property is other than farm assets (as defined) and five years if farm assets are transferred to a person other than your child).

In Appendix 5 there is an illustration of how these rules work.

Planning the sale

Whether you are selling to your children or to a stranger, there may be steps that can be carried out at the time of the sale to reduce or defer the income taxes that will arise. For instance, a sole proprietor with a non-calendar year-end may want to enter into the sale immediately after his year-end and before the end of the calendar year. Taxable capital gains arising from the sale would then be taxed in the calendar year in which the assets are sold whereas recaptured depreciation and income arising from the sale of livestock, inventories and quota would be taxed in the following year. Splitting the income in this manner may reduce the overall tax bite.

To the extent possible, the sale should be planned so that you benefit from block averaging. Since block averaging is available only every five years, you should be careful not to use this provision for the sake of saving a few hundred dollars of tax currently when it might have been used to save several thousands of dollars in the next year or two when you sell your farm.

You should also give consideration to the manner in which the sales consideration (e.g. cash and debt) is allocated to the various assets sold. This may affect the reserves that you may claim and the timing of the recognition of income. These and other matters are discussed in greater detail in "Taxation and the B.C. Farmer", published by the Ministry of Agriculture and Fisheries in British Columbia.

It should be noted that all of the above are matters to be taken into account before the sale. It is important, therefore, that you seek professional advice well in advance of the proposed sale date.

Purchase of a replacement farm

Upon retirement, you may want to sell the family farm and buy a scaled-down operation to keep you busy during your retirement years. Depending on the amount paid for the new farm and the timing of the purchase, it is possible that you will be able to defer some of the income tax arising on the sale of the original farm by taking advantage of the replacement property rules in the Income Tax Act. These rules are described in the booklet called "Taxation and the B.C. Farmer", published by the Ministry of Agriculture and Fisheries in British Columbia.

Special income tax rules applying to sales to children

Generally, when a taxpayer transfers assets to his children during his lifetime (an inter-vivos transfer) the transfer is deemed to take place at fair market value. If the transfer price is less than fair market value, there are rules in the Income Tax act that allow Revenue Canada to make an adjustment to the vendor's income without necessarily allowing a corresponding adjustment to the purchaser.

There are important exceptions to this fair market value rule in respect of certain farming assets transferred by an individual to his child. These exceptions have been made because of the capital-intensive nature of farming and the particular importance that has been given to the continued prosperity of the family farm in Canada. If each generation were required to account for tax on all the recaptured depreciation and inflationary gains realized on farm properties during the period it owned them, family farms would probably not survive. In many cases, substantial assets would have to be sold each time the farm passed from one generation to the next so that the family could pay its tax liability.

The concession that has been made to farmers is to allow them to choose the value for income tax purposes at which certain farming assets (referred to as qualifying farm properties) may be transferred during their lifetime to their children. The transfer value that is selected by the farmer and his child will determine the income tax consequences to the farmer and the cost of the acquired properties to the child.

Even though you are now entitled to a lifetime capital gains deduction of up to $250,000 (see Chapter 5, page 40 for details), the rules referred to above allowing you to select the transfer price of qualifying farm properties transferred to your children (the "rollover rules") are still important. The reasons for the continued importance of these rules are as follows:

1. The "rollover rules" apply to quota whereas the capital gains deduction does not.

2. The "rollover rules" enable you to avoid recaptured depreciation on buildings and equipment. The capital gains deduction does not apply to this income.

3. The capital gains deduction that is available to you may not fully offset the taxable capital gain arising on the sale of a particular asset. In this situation, you may wish to transfer a portion of the asset using the "rollover rules".

4. Transferring farming assets at fair market value and using the capital gains deduction to offset the taxable capital gains arising on the sale may result in you being subject to the new minimum tax (see discussion in Chapter 5, commencing on page 42). If this is the case, it may be more appropriate to transfer some assets at fair market value and others at a reduced value.

The qualifying farm properties that are eligible for the "rollover rules" and the range of transfer prices that can be selected are as follows:

TRANSFERS TO CHILDREN [3]

Property	Lowest Transfer Value [1]	Highest Transfer Value
Land [2]	Cost Amount (See Glossary)	Fair Market Value
Buildings, equipment etc. depreciated on the reducing balance basis [2]	Cost Amount (See Glossary)	Fair Market Value
Eligible capital properties (e.g. quota) [2]	2 x Cost Amount (See Glossary)	Fair Market Value
Shares in a family farm corporation (See Glossary for definition)	Cost Amount (See Glossary)	Fair Market Value
Interest in a family farm partnership (See Glossary for definition)	Cost Amount (See Glossary)	Fair Market Value

Notes

1. Generally, the selected transfer value cannot be less than the total of the debt assumed by your child and the amount he agrees to pay to you.

2. The property must be owned by you directly and, immediately before the transfer, it must be used by you, your wife, or any of your children

in the business of farming in Canada. This requirement will be met if the property is leased to a family farm corporation or a family farm partnership (see Glossary).

3. The term child includes a grandchild, great grandchild, daughter-in-law, son-in-law, adopted child, stepchild, an illegitimate child and certain other persons.

It is important to note that if the property is transferred at the lowest transfer value your accrued tax liability is not avoided - it is simply deferred. The liability is passed to the next generation together with the farm property.

Revenue Canada takes the view that the tax-deferred transfer (or rollover) does not apply to your principal residence located on the farm. However, the gain on the sale of the residence will often be exempt from tax under the general principal residence rules or will be taxed at a nominal amount because of the special rules applying to farmers' residences.

Revenue Canada has issued an Interpretation Bulletin (IT - 268R2) dealing with the inter-vivos transfer of farm property to a child. This Bulletin states that although the Income Tax Act requires that the qualifying property be transferred directly to a child the Department will, under certain conditions, permit the rollover to apply if the property is transferred to a trust for the benefit of a minor child. The Bulletin also states that a rollover will be permitted if the property passes to a partnership where all the partners are the taxpayer's children.

If property acquired by a child under the rollover rules is reacquired by the parents after 1983 as a result of the child's death, the rollover rules can be used a second time to transfer the property back to the parents on a tax-deferred basis.

It is to be noted that the qualifying property of a sole proprietor does not include his livestock and inventories or his depreciable property that is written-off on the straight-line method. These assets, if disposed of during the proprietor's lifetime, must be transferred to a child at fair market value. You might consider converting your "straight-line" depreciable assets to "reducing balance" assets prior to a transfer to your child in order to effect the transfer on a tax-deferred basis. This will not be necessary in respect of buildings which are eligible for the capital gains deduction - unless you have used all of the deduction available to you.

If you carry on your farming business through a partnership or a corporation you may achieve a more complete rollover of farm property to your children. Remember that if your farm assets are held by a family farm partnership or corporation, you are treated as owning a partnership interest or shares rather than the farm assets themselves. The partnership interest, or the shares in the corporation as the case may be, will be eligible for a rollover provided the partnership qualifies as a family farm partnership (see Glossary) or the corporation qualifies as a family farm corporation (see Glossary). The use of a corporation or partnership effectively allows you to transfer to your child on a rollover basis your cash basis inventories and your depreciable property depreciated on a straight-line basis.

Attribution of income to the farmer

If you transfer qualifying farm property to a child under the age of 18 on a rollover basis, taxable capital gains or allowable capital losses arising from the disposition of that property will generally be attributed back to you and included in your income, unless the child attains the age of 18 before the end of the year in which the disposition takes place.

Forgiveness of debt

If you sell qualifying property to your child at a stipulated value and subsequently decide to forgive a portion of the debt arising on the sale, you and your child may be exposed to a double tax. You would be better off to sell the property at a reduced value in the initial transaction.

To illustrate, let us assume that a farmer holds qualifying property, say land, worth $180,000 with an adjusted cost base of $100,000, and decides to transfer it to his child for $150,000. The child makes a down payment of $30,000 and issues a mortgage for $120,000. Subsequently, the father decides to increase the gift to his child and forgives $50,000 of the debt owing by him.

The consequences of this are as follows:

1. The father will be deemed to have realized a taxable capital gain of $25,000 on the original sale (1/2 x $150,000 - $100,000) and, depending on the circumstances, will probably be entitled to claim the capital gains deduction to offset this taxable gain.

2. The forgiveness of debt will reduce either the child's loss carry-forwards or the tax values of his depreciable property or capital property by $50,000 (section 80 of the Income Tax Act); and

3. Assuming the adjusted cost base of the child's land is reduced (see 2 above), the accrued gain on the property at the date the father transferred it to his child ($50,000) will be taxed a second time when the child sells the property.

If the land had been sold originally for $100,000, which could have been arranged because it is qualifying property, the consequences would have been as follows:

1. There would have been no taxable capital gain on the original sale and the father would not have needed to use up part of his lifetime capital gains deduction.
2. The child would have inherited his father's accrued capital gain and would have paid tax on it when he sold the property and realized the gain; and
3. There would have been no double tax or, alternatively, the father's capital gains deduction would not have been wasted.

There would not have been a problem in this hypothetical situation had the father decided to bequeath $50,000 of the debt to his child through his will. In that situation, Revenue Canada has stated that it will not reduce the child's loss carry-forwards or the tax values of his capital property.

GIFTS DURING YOUR LIFETIME

Why consider them?

If you have sufficient retirement capital, you may want to consider gifting property to your children rather than selling it to them. You may recognize for instance that your farming child will have difficulty "making ends meet" in the first few years of his farming business and the removal of debt servicing costs on particular assets may make a considerable difference. Perhaps the child has earned the "gift" as a result of the contribution he has made to the farm in previous years for which he has not been appropriately remunerated.

If you have sold a substantial portion of your farming assets you may want to consider the gifting of liquid assets to your children (e.g. cash) as a form of income-splitting within the family.

If a gift is made to one of several children, you may want to view it as being a payment on account of the distribution that the child will receive on your death. This can be accomplished through your will by placing a value on the gift and stating that the other children should receive an equivalent distribution out of the estate before the residue is divided among all your children.

You may want to transfer property to your wife if she is to become involved in your farming business.

Implications of making gifts

A gift of cash has no tax implications except that if the gift is made to your wife, or to a child who is a minor, the "income attribution rules" may have the effect of causing you to be taxed on the income earned by your wife or child on the funds gifted to them. These rules are discussed in Chapter 5.

Property other than cash that is gifted from one person to another is generally considered to be disposed of at fair market value and the person making the gift has to account for the income tax that is payable. There are some important exceptions, however, in respect of properties transferred to a child or a spouse.

Qualifying farm properties (see Glossary) that may be sold to your child at less than fair market value (see earlier discussion on page 23) may also be gifted to your child without adverse tax consequences. Where properties are gifted, they simply transfer on a rollover basis and your child inherits your tax position.

All capital assets such as land, buildings, equipment, shares in a family farm corporation and a partnership interest may be transferred on a rollover basis to a wife. The spouses can elect to have the rollover rules not apply for any or all these types of properties. Eligible capital properties (e.g. quota) will also transfer on a rollover basis if you cease to carry on the farming business and transfer it to your wife. This might happen, for instance, if you are injured and unable to continue working.

Property that does not transfer on a "rollover" basis between spouses includes the livestock, inventories and accounts receivable of a cash basis farmer which is transferred during his lifetime.

If you transfer property to your wife, attention will have to be given to the effect of the attribution rules. As mentioned above, these rules are discussed in Chapter 5. In summary, any income of an investment nature that your wife realizes from the transferred property (including taxable capital gains arising from the disposition of the property) will generally be attributed back to you. Business income will not be attributed, however.

BEQUESTS THROUGH A WILL

General income tax rules

Transferring assets by means of a will is known as bequeathing. Assets transferred in this manner are treated for income tax purposes as having been disposed of immediately before your death. Because of the new capital gains deduction and the extensive rollover rules applying to properties transferred to spouses and children this "deemed disposition" will not usually result in a substantial tax liability for your estate.

If your circumstances are such that the rollover rules do not apply, (perhaps because you do not have a wife and your farm assets are rented to a person outside the family), the income tax implications of disposing of your assets on death are as follows:

1. Your capital property such as land, shares in a farm corporation, your interest in a farm partnership, your

depreciable property written off on the straight-line basis, and your stocks and bonds, etc. are deemed to be disposed of at fair market value and the taxable capital gains or allowable capital losses realized on this disposition will have to be included in your income.

2. Depending on your circumstances, you will probably be able to claim the capital gains deduction to offset the taxable gains included in your income (see discussion in Chapter 5, commencing on page 40). If there is a substantial taxable capital gain and an offsetting capital gains deduction, you may be subject to the new rules dealing with the alternative minimum tax (see discussion in Chapter 5, commencing on page 42).

3. The depreciable property in each class that is written off on the reducing-balance basis is deemed to be disposed of at the mid-point between its fair market value and its undepreciated capital cost. Taxable capital gains, recaptured depreciation or terminal losses arising on this disposition will be included in your income.

4. If you are a cash-basis farmer, your livestock, inventories and accounts receivable (called "rights and things" in the Income Tax Act) are given special treatment. Your executors will have three options.

    (a) All or a part of the value of the rights and things can be included in your final return together with your other income; or

    (b) The executors can elect within certain time limits to include the rights or things in a separate tax return for the year of death and a second set of personal exemptions can be claimed; or

    (c) If the rights and things are transferred to a beneficiary within certain time limits, the value is included in their income when the rights and things are disposed of.

4. Your eligible capital property (e.g. quota) is deemed to be disposed of at two times the balance in your cumulative eligible capital account. In other words, there is a rollover.

5. There are special rules for resource properties and land that is held as inventory.

Bequests to a spouse or spouse trust

Property bequeathed to a spouse or to a qualifying spouse trust is deemed to pass on a "rollover" basis unless your executors elect to not have these rollover rules apply. This election is made on an individual property basis and gives your executors considerable flexibility in optimizing your tax position in the year of death. If, for instance, you have unutilized deductions or losses in the year of death, the executors may wish to elect that certain capital properties be transferred to your wife at fair market value, so as to generate taxable capital gains that will absorb these deductions or losses.

To qualify for the rollover, the property passing to your wife, must "vest indefeasibly" in her not later than thirty-six months after the date of death and this fact must be established within this period or within such longer period as is reasonable in the circumstances. The term "vested indefeasibly" means that she must obtain a right to absolute ownership which cannot be defeated by a future event. An example of a situation in which a property may not "vest indefeasibly" in a spouse is where shares of a farm corporation pass to her but she is bound by the terms of a shareholder agreement to sell them to the other shareholders. Revenue Canada deals with this and other potential problems in their Interpretation Bulletin IT - 449.

In order for property to pass to a spouse trust on a rollover basis, the terms of the trust must be such that all income of the trust arising before the spouse's death is received by the spouse. Moreover, no person other than the spouse can obtain the use of any income or capital of the trust during the spouse's lifetime.

This requirement is sometimes not met because of unintended technical problems in the drafting of the will. Remember, that Revenue Canada may discover these problems because a copy of the will is normally requested to be filed with the farmer's final tax return.

An example of a drafting problem in a will is a provision to the effect that in the event of the remarriage of the surviving spouse, the income of the trust shall no longer be payable to her and the trustee may no longer encroach on capital on her behalf. A farmer might consider this to be a reasonable provision to include in his will but would probably change his mind if he was advised that the normal disposition rules would apply to all the assets passing to the trust. There is no problem in stating that the ability to encroach on capital shall cease on remarriage, but there is a problem if the spouse is prevented from receiving the trust's income.

Bequests to children

"Qualifying farm properties" which can be transferred to your children on a rollover basis during your lifetime (see page 23) can also be transferred to them on a rollover basis on your death. As mentioned previously, these properties are land, depreciable property written off on a reducing-balance basis, eligible capital properties (e.g. quota), shares in a family farm corporation and an interest in a family farm partnership. The land and depreciable property must have been used in a farming business carried on in Canada, immediately before your death, by you, your wife or any of your children. This requirement will be considered to have been met if the property is rented to a family farm corporation or a family farm partnership (see Glossary).

Your personal representatives can not only choose to have farming assets "rolled over" to your children, they can, instead, choose to have some or all of them disposed of for income tax purposes at any amount between their cost amount (see Glossary) and their fair market value. In this respect, they have almost the same flexibility as you would if you disposed of your assets during your lifetime.

It is important to note that the assets for which your personal representatives can choose the transfer values include all the "qualifying farm properties" listed on page 23 except eligible capital property (eg. quota). This latter asset always transfers on a "rollover basis" when it is transferred to a child through a will.

Now that your personal representatives can select the transfer values of most assets passing to the next generation and can claim the capital gains deduction to offset any taxable capital gain included in your income, the strategy will generally be to select the highest possible transfer value that does not result in tax being paid by your estate. In making this selection, the personal representatives will have to take into account the possible impact of the minimum tax (see discussion in Chapter 5, commencing on page 42).

Land, depreciable property written off on a reducing-balance basis, shares in a family farm corporation and an interest in a family farm partnership will not be eligible for the "rollover" and will be deemed to be transferred at fair market value if it does not vest indefeasibly in your child within thirty-six months of the date of death. The fact that the vesting requirement was met must be established within that thirty-six month period or within such longer period as is reasonable in the circumstances. Where there is a will, this vesting provision will not be a problem because the property is treated as having vested immediately after your death. However, if there is no will, the vesting requirement could be a problem and may even result in a loss of the rollover.

The rollover may also be lost because of unintended drafting problems in your will. The type of problems that can be encountered are discussed in Chapter 10 and in Revenue Canada's Interpretation Bulletin IT - 449.

Farmers who are sole proprietors and do not have sufficient liquid assets to satisfy the cash bequests to their children or other members of their family, may want to provide in their wills that before the farm land is distributed to the child who is to carry on the farm, a mortgage is to be placed on the property with the proceeds of the mortgage being paid into the estate. It is to be noted that the "tax cost" of the land will not be increased by any portion of the mortgage placed against it by the taxpayer's executors. Furthermore, Revenue Canada has stated that the farming child will not be able to deduct interest payable on the mortgage.

A better method of generating liquid funds in the estate is to arrange for your farming child to have the option of purchasing certain farm assets from the estate. Provided the assets consist of land, depreciable property written off on a reducing balance basis, shares in a family farm corporation or an interest in a family farm partnership (see Glossary), this purchase need not be made at fair market value. Irrespective of the actual sales price, your executors have the ability to deem the sales price for tax purposes to be any amount between the property's cost and its fair market value. The amount chosen will be the proceeds in your final return and the cost to your farming child. Generally, your executors will choose the highest amount that will not result in tax. If your farming child is required to pay interest to the estate, it will be deductible for income tax purposes.

This type of arrangement was made possible only recently as a result of a change in the Income Tax Act. Before this change was made, a sale of property by the estate would have resulted in the deceased farmer being deemed to have disposed of the property at fair market value.

Another matter dealt with in Interpretation Bulletin IT - 349R is that where a farmer bequeaths an interest in a family farm partnership to a child, the personal representatives will not be able to select the transfer price for income tax purposes unless the child becomes a partner in the partnership. It is not sufficient for the child to simply inherit a right to receive property from the partnership.

Revenue Canada has issued an Interpretation Bulletin (IT - 446) dealing with legacies in which they state that a taxpayer occasionally bequeaths property to a child on condition that the child provide for the maintenance of the surviving parent during his or her lifetime. The manner in which this arrangement is established will have an effect on the income tax that the child will pay. If the obligation of the child is an unsecured personal liability, all of the income he receives from the bequested property will be taxed in his return and he will not obtain a deduction for the amounts he pays to his surviving parent. If, on the other hand, the obligation to pay stated amounts to the parent is secured by a charge on the property bequeathed to the child, the income from the property that he reports in his return is reduced by the amounts paid to the parent.

Bequest to children through a spouse trust

A farmer who wants his spouse to enjoy the income from the farm after his death, and to have the property pass to his children on his spouse's death can achieve this by using a spouse trust. On the farmer's death, the qualifying property will pass into the trust on a rollover basis. When the spouse dies, the property will pass out of the trust to the children at any value selected by the trustee that is between its cost amount (see glossary) and its fair market value. The property that is eligible for this treatment is land, depreciable property written off on a reducing-balance basis, shares in family farm corporations and interests in family farm partnerships.

LEASES

A farmer who has children who are not involved in the farming business may bequeath his land to them on the understanding that before the land is distributed from the estate, a lease be entered into with the children who are running the farm. Some commentators have expressed the view that land will not be eligible for a rollover in this situation because the existence of the lease prevents the land from vesting indefeasibly in the non-farming children. Revenue Canada does not appear to consider this to be a problem unless the lease gives the farming children an option to acquire the property. In that situation the land may not vest indefeasibly and the rollover may not apply. This is discussed further in Chapter 10 dealing with estate planning problems.

In order to avoid the possibility of expensive mistakes, farmers who are considering a lease arrangement should receive advice from a professional who is knowledgable in tax matters. This adviser may wish to seek a ruling from Revenue Canada in some situations.

CHAPTER 5

TAX PLANNING DURING LIFETIME

Retirement income planning

Your financial security during your retirement years will be a major factor in your estate plan. It will have a significant impact on the manner in which you transfer your farming interests to your children because the capital realized from this transfer will often provide you with a substantial portion of your retirement income. The possible ways of dealing with your farm property are discussed in Chapter 4.

In planning your retirement, you will have to consider whether you will need to purchase a new home off the farm. You will also have to think about your activities during retirement and whether by staying on or near the farm you can be useful to your children. Ideally, you will continue to be involved in the family business so that there is a gradual transition from an active farming life to the life of a retired farmer.

In assessing your need for retirement capital you must take into account the effect of inflation. As we have seen in the past few years, a prolonged period of inflation at rates in the range of 8% - 12% can significantly erode an individual's purchasing power. A retired farmer who is debt-free will probably be shielded from the effects of inflation to some extent, particularly if he obtains much of his food from the land. However, even in this situation, inflation must be considered.

In developing your estate plan, you should estimate your annual retirement income from sources such as government pensions, private pensions and income from the sale or leasing of farm assets. You should compare this income to your estimated expenditures on a year by year basis over the retirement period, ensuring that some adjustment is made for inflation. You should then take this calculation one step further by estimating the extent to which the projected incomes and expenditures will be affected by your death or the death of your wife. There will, for instance, be a substantial impact if you have a significant private pension from a registered retirement savings plan that will no longer be payable after your death. In this second set of projections, you will take into account the effect of any life insurance on your life or that of your wife.

These calculations should not be overly difficult for an individual who has been in business for much of his life. You may need assistance from your accountant in estimating your tax liability throughout retirement but, generally, you should be able to do most of the work yourself.

The calculations should not be left until the last minute. They will have to be reworked at the time you are planning to retire but they should be done on a preliminary basis much before that time so that you are able to give an appropriate amount of thought to your options. Avoid placing yourself in the position of having agreed to an overall estate plan with your family and then discovering that it does not provide you with financial security.

In the year in which you retire, you may have an unusually large income for income tax purposes. As will be discussed later, you may be able to achieve significant tax savings on this income by timing your retirement so that you can take advantage of block averaging and forward averaging. To do this you must plan for your retirement in advance.

If your large retirement income includes a substantial capital gain which is eligible for the capital gains deduction, it will be necessary to not only estimate the regular income tax liability but also the minimum tax liability as well. If the minimum tax liability is higher, some advance planning may be required to determine if it can be reduced.

As mentioned above, the existence of private pensions and government pensions will affect your estate plans. These and other matters affecting retirement are discussed below.

Income from farm assets

The bulk of your retirement income will usually be received from your farming property or from the assets you have received in exchange for this property. This income may come in several different forms:

a) dividends on shares in a farm corporation;

b) interest on debt owed by your children, or by others, in respect of the purchase of your property;

c) income from the investment of cash received on the sale of assets;

d) rental income from farm property rented to your children or to others; or

e) farm income if you continue to be an income-sharing partner after retirement.

The manner in which you will deal with your farm property will depend on a number of factors such as the number of children, whether some or all of them are interested in farming, the amount of non-farming assets, your intentions with respect to the distribution of your property and your ability to claim the capital gains deduction. The possible ways of dealing with your farm property are discussed in Chapter 4.

Registered Retirement Savings Plans (RRSP's)

This type of private pension plan is well known to most taxpayers. Farmers and other individuals who have "earned income" are able to contribute up to $7,500 to an RRSP for 1986 and 1987 ($5,500 for 1985 and previous years). The amount contributed must be paid into the plan during the year or within sixty days after the end of the year. An RRSP cannot be assigned as collateral for a bank loan but it can be a very useful tool in saving for retirement and deferring income taxes.

Currently, you can contribute up to 20% of your "earned income" to a plan each year, although the amount contributed cannot exceed $7,500 ($5,500 for 1985 and previous years). This limitation is reduced to $3,500 in certain situations, if you are employed and a member of your employer's pension plan or deferred profit sharing plan. The term "earned income" includes income from employment, business income, rental income and pension income.

In the period 1988 through to 1991 the government has proposed that the maximum annual contribution be increased to $15,500. The contributions for all years subsequent to 1987 will be restricted to 18% of the earned income in the previous year and will be reduced if the individual is a member of a pension plan. Any unused RRSP contributions after 1987 may be carried forward for up to seven years.

You can contribute to your wife's plan instead of your own or can allocate your contribution between them. This is a useful method of "splitting income" between you and your wife and can result in the saving of income taxes during retirement. It should be remembered that if funds contributed to your wife's RRSP are withdrawn in the year they are contributed, or in the following two years, they are included in your income rather than the income of your wife. Once this time period has elapsed, funds withdrawn from your wife's plan are included in her income.

You are able to designate a beneficiary in the plan itself and the person named therein should receive the proceeds of the plan after you die. Generally speaking it is also advisable for you to name the beneficiary in your will.

Full-time farmers (as defined) or their spouses, who realized capital gains on the sale of "qualifying farm property" in 1984, are able to make special contributions to an RRSP of up to $120,000. The ability to make these special contributions continues indefinitely until the maximum amount has been contributed. "Qualifying farm property" includes:

- real property used in the business of farming at some point between 1972 and 1983 inclusive, by the farmer, his spouse, any of his children or a farm corporation or partnership of the family;
- a share of a family farm corporation (see Glossary); and
- an interest in a family farm partnership (see Glossary).

This provision was withdrawn for sales after 1984 as a result of the introduction of the capital gains deduction. If you disposed of "qualifying farm property" in 1984 you should consult with your accountant to see if you are still able to make a special RRSP contribution.

It is important for you to remember that if the beneficiary of your RRSP is a person other than your wife, the amount in the plan at the date of your death (including the commuted value of any annuity you might have been receiving from the plan) will be included in your final tax return. Your executors may be able to claim some deductions but only in respect of the RRSP funds passing to your children who were dependent on you immediately prior to death.

If, on the other hand, your RRSP funds pass to your spouse there will be no adverse tax consequences. If your plan had not matured, your wife will receive a refund of the amount in the plan which she can then contribute to her own RRSP. If your plan had matured and you had commenced to receive annuity payments, these payments will simply pass to your wife (assuming the plan provided for this) and will be taxable in her hands as she receives them.

You must decide the manner in which you will use your RRSP funds. You can simply withdraw the funds in a lump sum, you can use them to purchase a life annuity or a term annuity to age 90 or you can transfer them to a registered retirement income fund (RRIF) (see below). One of these options must be selected before the end of the year in which you reach the age of 71.

If you purchase a life annuity, you should decide whether there should be a joint and last survivor option under which payments will continue until the death of the survivor of you and your wife. If you are in poor health, you may want to consider this option or consider the purchase of an impaired annuity which takes into account your reduced life expectancy. You will also want to consider whether the annuity should be paid for a guaranteed minimum period and whether there should be an inflation factor built into the monthly payments. Some of these "bells and whistles" will tend to reduce the monthly income in the early years of retirement but in many cases it will be appropriate to have them.

The Income Tax Act has been amended recently to allow an individual to purchase an annuity at any time and to allow him to make partial withdrawals from an existing RRSP and bring the amounts into income. This change together with others affecting RRIF's (see below) means that individuals will be able to opt out of existing arrangements at any time. This increased flexibility will make RRSP's more attractive.

If you are receiving Canada Pension or Old Age Security payments and do not require them to live on, you may transfer them to your RRSP without affecting the amount of your deduction based on your other "earned income". These payments are included in the definition of "earned income" and so 20% can be contributed to a plan for your spouse.

All of the financial institutions offer several different types of plans. Their performance may vary considerably as will the rules dealing with administration fees, the ability to withdraw capital, etc. Some of the plans will invest in common stocks, others will invest in fixed income securities, mortgages or bank deposits. Because there are so many different plans and their relative performance can have a significant impact on the funds that you will have on retirement, you should be prepared to shop around for a plan that suits you. There are a number of booklets on the market that will assist you in doing this.

Registered Retirement Income Funds (RRIF's)

As mentioned above, you have four retirement options with RRSP's. You can either withdraw the funds in a lump sum, use the funds to purchase a life annuity, a term annuity to age 90 or transfer them to a RRIF.

In the past, the life annuity option has generally produced the largest annual cash flow during the period of normal life expectancy and has been the preferred option. However, as a result of the recent changes to RRSP's (see above) and the new rules dealing with RRIF's, the RRIF option will become more popular.

Under the old rules, an individual could establish only one RRIF and was required to withdraw his funds on a formula basis over a period ending with the year in which the individual reached the age of 90. As an alternative, the payments could be spread over the period ending with the year that his spouse reached the age of 90, provided the spouse was younger than the individual.

Under the new rules:

- an individual can have more than one RRIF;
- there will be a minimum withdrawal computed on a formula basis to age 90, but the individual will be able to withdraw a greater amount if he wishes. This additional withdrawal can be taken in the form of lump sum payments or as a life annuity; and
- funds will be transferable from one RRIF to another.

A RRIF can be established through several different financial institutions such as credit unions or trust companies whereas a life annuity may only be purchased from a life insurance company.

Canada Pension Plan

The Canada Penson Plan is an earnings-related contributory plan that provides for a retirement pension and certain supplementary benefits. Contributions based on income are required from the age of 18 to the age of 65 (or 70 if you continue to work and do not apply for your retirement pension). Farmers aged 65 and over can, if they wish, draw their retirement pensions whether or not they continue to work and receive income.

The retirement pension is 25% of your "average monthly pensionable earnings". The "average monthly pensionable earnings" represents your total pensionable earnings from the start of the Plan, or from age 18, whichever is later, averaged over the period you have contributed to the Plan and expressed on a monthly basis. The maximum retirement pension is earned by making contributions at the maximum level throughout your working life. To save people from being penalized if they have had periods of sickness, unemployment or low income, there is a provision for the elimination of up to 15% of the contributory period without affecting the calculation of the pension.

The contribution required from a self-employed farmer for a particular year is 3.6% of the difference between his net earnings for that year (not exceeding the maximum pensionable earnings ($25,800 in 1986)) and his annual exemption ($2,500 in 1986). If the farmer is employed by a farm corporation, one-half of the contribution is made by him and the other half is made by his corporation.

The present maximum pension under the Canada Pension Plan is $486 per month. The supplementary benefits are as follows:

- a pension to you and to your children, if you become disabled;
- a pension to your wife, if she is widowed; and
- a death benefit to your estate.

Old Age Security

The Old Age Security Pension, known as the old age pension, is a flat rate pension that is payable to any person who meets the age and residency requirements. The amount paid is adjusted each quarter to reflect the increase in the Consumer Price Index.

The pension becomes payable when you reach the age of 65. Individuals who were aged 25 or more on July 1, 1977 and arrived in Canada prior to that date will be eligible for the full pension if they reside in Canada without interruption for the ten years preceding the date they apply for the pension. Individuals who did not reside in Canada prior to July 1, 1977 or were not aged 25 on that date will receive a reduced pension unless they reside in Canada for at least forty years after age 18.

The old age pension payable on October 1, 1986 is $294.43 per month.

Block averaging

The most widely-used method of income averaging available to farmers is the five-year block average. The use of this form of averaging can result in substantial tax savings throughout your business life and, in particular, in the year in which you retire. As its name suggests, block averaging can only be used at intervals so its use should be well-planned.

The mechanics of the averaging calculation are complicated but are explained in detail in Revenue Canada'a Taxation Guide for Farmers and Fishermen. The effect of the calculation is that all income received in the period of averaging (generally five years) is treated as though it had been received in equal annual amounts over the averaging period. This can give rise to tax savings as a result of the following:

- the deduction of personal exemptions or losses that were not deducted in previous years in the averaging period because you did not have sufficient income in those years; and
- the application of lower tax rates than would otherwise have applied in the "higher income" years.

In the year in which you retire you may have a substantial income for tax purposes. If you do, it will probably be advantageous to arrange the timing of your block averaging election so that you can make an election in the year of retirement. Obviously, this requires some advance planning.

In the year in which you elect to block average you are not subject to the new rules dealing with the Alternative Minimum Tax (see discussion commencing on page 42.) This is an additional reason to plan the use of the election.

Forward averaging

Forward averaging was introduced into the Income Tax Act in 1982 and is available to all individuals. Unfortunately, it is not as beneficial as the "averaging" that used to be available through the purchase of income-averaging annuities.

The benefit that can be derived from forward averaging is the ability to have income spread over a number of years and taxed at marginal rates that are lower than the rate that would have applied had the income been fully taxed in one year. There may be a cost, however, in that the income that is to be "forward-averaged" is initially taxed at the top rate and this rate may be higher than the rate that would otherwise have applied. You should, therefore, compare the tax saving that may ultimately be obtained through a reduction in the tax rate, with the cost of prepaying income taxes.

When you retire, forward averaging can be combined with block averaging to achieve significant tax savings. Ideally, you should arrange your affairs so that you can block average in the year in which you retire, or in the previous year if that is appropriate, and then forward-average after your retirement.

More information on forward-averaging can be found in "Taxation and the B.C. Farmer", published by the Ministry of Agriculture and Fisheries in British Columbia.

Capital gains deduction

General comments

A recent development in the estate planning area which is of considerable importance to you is the lifetime capital gains deduction. Commencing in 1985 individuals and certain trusts became entitled to a cumulative deduction from income in respect of the first $500,000 of capital gains (or $250,000 of taxable capital gains). For most taxpayers this lifetime deduction is being phased in over a number of years but, for farmers, the full deduction applies immediately if the capital gain arises from the sale of certain farming assets (see below).

It is important to note that the deduction is not available to a corporation. The only manner in which an incorporated farmer can benefit from it is to sell the shares of his company. It is also important to appreciate that the deduction applies to each individual. If you and your wife own the farm jointly, you are each entitled to the $250,000 deduction.

The farming assets which are immediately eligible for the full deduction are as follows:

(1) Land and buildings used in a farming business by

- the individual, his spouse or any of his children;
- a "family farm corporation" (see Glossary) of the individual, his spouse or any of his children;
- a "family farm partnership" (see Glossary) of the individual, his spouse or any of his children.

(2) A share of the capital stock of a "family farm corporation" (see Glossary); and

(3) An interest in a "family farm partnership" (see Glossary).

Land and buildings which are rented to a person outside the family by a retired farmer will nevertheless be eligible for the full deduction immediately provided the property was used in farming by the farmer, his spouse or child (or by a family farm corporation or family farm partnership - see Glossary);

- in the year the property was sold, or
- in at least five years during which the property was owned by the farmer, his spouse or his child.

Property that is not immediately eligible for the full deduction is nevertheless entitled to a phased in deduction on the following basis:

	Cumulative Deduction (taxable gains)
1985	$ 10,000
1986	25,000
1987	50,000
1988	100,000
1989	150,000
1990	250,000

It is to be noted that the deduction is available only in respect of capital gains. Therefore, income arising from the sale of quota or livestock is not eligible for the deduction.

The new capital gains deduction is not affected by the claiming of an exemption in respect of the capital gain on the sale of a principal residence.

If a taxpayer sells capital property in exchange for debt, he is entitled to claim a reserve for income tax purposes in respect of the unpaid proceeds, which has the effect of spreading the capital gain over a number of years. If the property being sold is one for which the full exemption is available (eg. land, buildings, family farm corporation or family farm partnership) the capital gains deduction can be claimed in each year in which a portion of the capital gain is included in income. If the property is not one of these assets, however, (perhaps because it is land that was not used in farming for at least five years) the capital gains deduction can be claimed only in the year in which the property is sold.

Where a taxpayer has sold a capital property before 1985, any capital gains reserves carried forward into 1985 and future years are not eligible for the deduction.

The manner in which the income tax law has been drafted caused some tax experts to question whether the capital gains deduction will be available to individual partners of a partnership if the partnership itself sells the farm property. Revenue Canada has recognized the potential problems and has stated publicly that it will administer the Income Tax Act as though the capital gains deduction is available to partners.

At the time the capital gains deduction was introduced, the rules applying to individuals with respect to the deductibility of net capital losses were changed. Previously, net capital losses could be deducted from up to $2,000 of other income each year. This deduction has now been restricted to allowable capital losses incurred before May 23, 1985 (called pre 1986 capital losses). If an individual deducts any pre 1986 capital losses from his other income in 1985 and subsequent years, he will not be able to claim the capital gains deduction in subsequent years until after an equivalent amount of net taxable capital gains have been included in income.

If, in 1985 or subsequent years, an individual has claimed a small business investment loss in respect of investments in certain taxable Canadian corporations, he will not be entitled to the capital gains deduction until after an equivalent amount of net taxable capital gains have been included in his income.

Implications of the capital gains deduction

The implications of the new capital gains deduction are significant, particularly now that you can transfer many of your farming assets to your children at any value between their cost amounts (see Glossary) and their fair market value. This applies whether the transfer is made in your lifetime or upon your death (see Chapter 4 for details). The strategy in many cases will be to transfer farming properties from one generation to the next at a value that will, to the extent possible, enable each generation to use its capital gains deduction. The effect of this will be to "step-up" the cost of the property to each generation and, ultimately, to reduce the taxable capital gain on the sale of the farm. Of course, this strategy must be assessed in relation to your need for capital and your desires regarding the treatment of your non-farming children. It also must be assessed in light of the possible impact of the minimum tax (see below).

Given that the new deduction applies only to the gains on capital properties held by a farmer who is a sole proprietor whereas it applies to all gains of a farmer who holds his assets in a family farm partnership or a family farm corporation (see Glossary), there may be an increased tendency to use partnerships and corporations.

If you are holding land on which there is a substantial accrued capital gain, you may wish to incorporate your farm and make use of your capital gains deduction. This is discussed on page 49.

Alternative minimum tax

In response to political pressure from people who were upset about certain individuals receiving substantial income without paying "a fair tax", the government has introduced an "alternative minimum tax". This new tax is to apply to 1986 and future years and obliges many taxpayers to calculate their tax liability under two different methods each year. The new tax calculation was intended to apply primarily to individuals who avoided paying tax by investing in tax shelters of one kind or another. However, the rules are such that it could also apply to farmers who realize a significant capital gain on the sale of their farm.

It is indeed unfortunate that the government felt it necessary to introduce this minimum tax because it tends to take away some of the benefits of the new capital gains deduction - particularly for the unwary taxpayer. On the one hand, the government has provided farmers with a lifetime exemption from tax on the first $500,000 of capital gains and on the other it has imposed an additional tax if the effect of this exemption is to reduce the farmers' tax below a certain level.

Tax Planning during Lifetime

In most situations involving the transfer of a farm from a parent to his child, it should be possible to avoid the minimum tax if the proper planning is done before the transaction is carried out. Where the farm is being sold to a person outside the family, the scope for planning may not be as significant.

It is important to realize that the alternative mimimum tax can apply in any year, including the year of death (except where the death occurred in 1986).

Outline of the new tax calculation

As indicated by its name, the new tax calculation is intended to ensure that all Canadian individuals and trusts pay at least a minimum amount of tax. Individuals and trusts with substantial incomes must calculate their taxes under the regular method and under the alternative method and pay whichever is the higher. If the alternative tax is higher, the amount of the excess can be carried forward and deducted from the regular tax liability in the seven subsequent years. Where a taxpayer dies, any unused carry-over may be deducted from the deceased person's regular tax liability for the three years preceding the year of death.

The carry-over of these additional taxes cannot reduce a taxpayer's liability to an amount that is below his minimum tax for the year.

Computation of the minimum tax

The minimum tax is based on an individual's "adjusted taxable income". This is calculated by starting with net income as determined under the regular method and by adding or subtracting a number of items. After the "adjusted taxable income" has been determined, the minimum tax rate (approximately 25% in B.C.) is applied to determine the minimum taxes payable.

From an estate planning perspective, the significant adjustments which are made in determining the minimum tax liability are as follows:

Amounts added to income

(1) The excluded one-half of capital gains (other than those applying to principal residences).

(2) Registered retirement savings plan contributions.

Amounts deducted from income

(1) A $40,000 basic exemption.

It is important to note that the minimum tax is not reduced by the dividend tax credit which is deducted from the regular tax liability if the individual receives taxable dividends from a Canadian corporation. As a result, an incorporated farmer who receives a substantial dividend from his corporation may find that his minimum tax liability exceeds his liability under the regular method.

Because of the annual $40,000 exemption, the minimum tax will generally apply only in situations where you realize a substantial capital gain or receive a significant dividend. To the extent possible, the imposition of this tax should be considered in advance of any transaction that is likely to generate this type of income. It should therefore be considered before finalizing the sale of a farm. It should also be considered by the executors of an estate in determining the values at which qualifying farm property are transferred to children (see Chapter 4).

One final comment concerning this new tax calculation is that it does not apply to the following:

- a taxation year in which the individual has elected to block average; and
- special returns filed by the representatives of a deceased person to report certain types of income (see Chapter 9).

In Appendix 6, there is an illustration of the new minimum tax calculations.

Other tax deductions and exemptions during retirement

If you and your wife are retired, you can reduce your income tax liability by claiming certain deductions and exemptions available to you.

Pension income deduction:	Individuals can deduct up to $1,000 of their qualifying pension income. An annuity from an RRSP or payments from an RRIF will qualify if they are aged 65 or older. Canada Pension and Old Age Security payments do not qualify.
Age exemption:	This exemption, which is indexed to inflation, can be claimed by each person aged 65 or older. The amount deductible in 1986 is $2,610.
Interest and dividends deduction:	This deduction of up to $1,000 may be claimed in respect of interest from Canadian sources and dividends from certain taxable Canadian corporations. Income received from relatives and dividends received from a controlled corporation are not eligible.

If you or your wife are not able to fully utilize the above deductions, the unused portion may be deducted by the other spouse.

Other planning

Income splitting

The reduction of income taxes is an important objective of estate planning and in the past this was sometimes achieved by income splitting within the family. The possibility of continuing to obtain tax savings in this manner has been curtailed recently as a result of amendments to the "attribution rules" (see Glossary) in the Income Tax Act.

These rules provide that where property has been "transferred" by a taxpayer to his spouse or to a person who subsequently becomes his spouse, any income or taxable capital gains realized from the transferred property or from property substituted therefore, will be attributed to the transferor for purposes of the Income Tax Act. The income or taxable capital gains may legally belong to the recipient of the transferred property (the transferee) - but will be taxed in the hands of the spouse who originally owned the property (the transferor). This rule applies only while both spouses are alive, they remain married and are residents of Canada.

A similar rule applies to transfers made to minors. Where a taxpayer has "transferred" property to a minor, the income earned thereon in years before the year in which the minor reaches the age of 18 will be taxed in the hands of the taxpayer. Any taxable capital gains realized from the disposition of the transferred property will generally not be attributed back to the transferor.

Several years ago, the Tax Courts decided that the word "transfer" as it is used in the attribution rules did not include a loan. Therefore families were able to split income between its members by arranging for the high-income spouse to make an interest-free loan to the lower-income spouse, or to minor children. The income earned on the loaned funds was taxed in the hands of the person receiving the loan and was not attributed back to the person who made it.

This strategy has now been prevented by an amendment to the Income Tax Act which broadens the meaning of the word "transfer" to include a loan. This amendment is effective for loans outstanding on or after May 22, 1985 except that in the case of a loan outstanding on that date, the new rules will not apply if the loan is repaid before 1988.

The news is not all bad, however, because it is now possible for one spouse to purchase a property from the other, and provided the transaction is carried out at fair market value, any future income from the property, or a future capital gain from its disposition, will not be attributed back to the original owner.

It is to be noted that the spousal income attribution rules apply only in respect of income received from transferred property, they do not apply to business income. Accordingly, if you transfer land and buildings to your wife and she uses them in carrying on a farming business, the farm profits will not be attributed back to you.

Tax shelters off the farm

The term "tax shelter" is applied to a wide variety of tax deferral plans that permit an investor to deduct a substantial part of his investment from income currently, or allow him to shelter income from tax indefinitely. In some cases, the plans permit the investor to pay for his investment over a number of years and to finance his contributions through tax savings.

The types of tax shelters now available are:

- limited partnership investments in hotels and other businesses;
- research and development investments;
- real estate investments; and
- oil and gas properties.

Investing in tax shelters is not usually of interest to many farmers because they obtain a sufficient shelter through being able to use the cash basis of reporting in their farm business.

Farmers who have businesses with low debt loads and could use additional tax deductions will often not consider the typical tax shelter because they are not able to evaluate their investment merits. They would prefer to put their savings in a solid investment that is more closely related to their business.

A detailed discussion of tax shelters is beyond the scope of this publication. Suffice to say that there are many different types available, each entitling the investor to a tax credit or to a deduction for all or a part of his investment. These tax benefits must always be put in the proper perspective. They will enable the investor to recover a portion of his investment and reduce the amount that he has "at risk" if the investment fails, but the over-riding factor must be the underlying merits of the investment. There is a popular saying that there is no point in throwing away a dollar to achieve a tax saving of 50 cents! This is what people do when they invest in tax shelters which do not have investment merits!!

CHAPTER 6

USE OF CORPORATIONS IN ESTATE PLANNING

Introduction

Many farmers consider a corporation to be a cumbersome and expensive vehicle in which to carry on a farming business. They share this opinion because the incorporated farmer is required to prepare an additional tax return and more extensive accounting information; he must become familiar with an additional set of tax rules; he will lose his ability to block average, he will probably have to pay a significant legal and accounting bill to transfer his assets to a corporation and finally, he will have to contend with additional legal formalities.

All of this is true, yet the corporation has its place in estate planning. It can be useful to the farmer who has a successful, mature business and is looking for ways in which he can defer income taxes. It can also be useful to the farmer who has several non-farming children and relatively few non-farming assets and is trying to develop an equitable estate plan.

A complete discussion of the use of corporations is beyond the scope of this publication. Additional information can be obtained from the booklet called, "Farm Business Corporations in British Columbia", published by the B.C. Ministry of Agriculture and Fisheries.

Income Tax Deferral

As explained in Chapter 3, a Canadian-controlled private corporation carrying on a farming business in Canada pays tax at the rate of 23% (excluding surtax) on the first $200,000 of taxable farm profits each year. This rate is scheduled to reduce to 22% on July 1, 1987 and 21% on July 1, 1988. Profits in excess of this amount are taxed at approximately 52% (before surtax). This higher tax is scheduled to reduce to 51% on July 1, 1987, 50% on July 1, 1988 and 49% on July 1, 1989.

If the farm corporation is associated (as defined in the Income Tax Act) with other corporations, the $200,000 limit is shared among them.

Previously, a corporation eligible for the low rate of tax was liable to a second tax (referred to as the "distribution tax") when it distributed its after-tax profits to its shareholders. This "distribution tax", calculated as 12 1/2% of the taxable dividends paid, applied only to dividends paid out of profits taxed at the low rate and accumulated in years commencing after 1982. This tax was repealed January 1, 1987.

The repeal of the distribution tax was offset by a reduction in the dividend tax credit that is available to individuals and trusts in respect of taxable dividends received from Canadian corporations. The effect of these two changes, taken together, is that the corporate tax will now be lower and the shareholder tax will be higher. On an overall basis, however, the total tax cost of receiving farm income through a corporation will remain relatively unchanged.

Because a farm corporation is taxed currently at only 23% on the first $200,000 of farm profits, there is a significant opportunity for tax deferral. This is illustrated in Appendix 3 on page 82.

Dealing with non-farming children

As discussed in Chapter 10, one of the most common estate planning problems for a farmer is to develop a plan that treats his non-farming children equitably (not necessarily equally) and allows his farming children to continue operating the business. Sometimes these objectives cannot be reconciled and the farmer, his executors or his children are obliged to sell a substantial portion of the farm to persons outside the family. In some situations, however, the use of a corporation provides the answer to the farmer's problem. The outline of one arrangement that might work in some situations is illustrated hypothetically in Appendix 4 on page 84.

Other matters to consider

(a) Principal residence

If you are considering incorporation you will want to consider whether you should keep your principal residence outside of the corporation. If you continue to own it personally you will retain the ability to claim the principal residence exemption on the home and up to 1/2 hectare of land and will continue to be eligible for the home-owner's grant.

In the past, the decision as to whether to retain the principal residence outside the corporation was sometimes influenced by whether the home was on a small acreage with a separate legal title. If it was situated on a large acreage together with the farm buildings, the entire property was often transferred to the corporation because there was a concern that perhaps the principal residence portion could not, by itself, be left outside the corporation and if the whole property was left outside, it would not qualify for "rollover" to the farmer's children. This latter concern is no longer a problem because the Income Tax Act now provides that property leased by an individual to a corporation that qualifies as a family farm corporation of the individual, his spouse or his child (see Glossary), or to a partnership that qualifies as a family farm partnership of the individual, his spouse or his child (see Glossary), qualifies for the "rollover".

Some farmers who have built their homes on the main farm have attempted to keep their principal residences outside the corporation by transferring only a partial interest in the property. The undivided interest that they retain is equal to the proportion of (a) the value of the home plus 1/2 hectare of land to (b) the value of the whole property. Revenue Canada has indicated that it does not consider this arrangement to be valid in a strictly legal sense. However, if the farmer's solicitor is prepared to use it and the farmer recognizes that it may complicate his financing arrangements at some point in the future, he may not have much to lose by trying it.

Capital gains deduction

The new capital gains deduction may influence your decision as to whether to incorporate and, if you do, whether you should hold your land inside the corporation or outside of it.

As mentioned in Chapter 4, the capital gains deduction is available only to individuals. Therefore if you incorporate your farm and the corporation sells its assets, the capital gains deduction will not be available. In theory you can still benefit from the deduction by arranging to sell your shares rather than having your corporation sell its assets. In some situations you may even make better use of the deduction because it can be used to offset the capital gain on the whole farm and not simply the gain on the capital property such as the land and buildings. It must be recognized, however, that in many situations, a purchaser is not interested in the whole farm and this makes a sale of shares more difficult.

If there is a substantial accrued capital gain on your land, you may consider transferring it to a corporation at fair market value and claiming the capital gains deduction to eliminate tax on the capital gain that would be created. You would take back debt as part of the consideration for the sale and would cause the corporation to repay this debt - free of income tax, out of future profits.

Depending on the amount of the capital gain and the size of the debt, you may be able to structure the transaction so that you receive a non-taxable repayment of your debt over several years and do not require further distributions from the company, during this period, either in the form of a taxable salary or a dividend. If this is the case, you may be able to defer a substantial amount of tax. This is illustrated below.

Assume:

Farm profits are $60,000 per annum.

The owner's tax exemptions and deductions amount to $5,000 per annum.

The land has a fair market value of $400,000 and an adjusted cost base (see Glossary) of $100,000.

All the assets are transferred to a corporation. The land is transferred at fair market value; other assets are transferred on a rollover basis by filing an income tax election.

The consideration given by the corporation includes $400,000 of debt.

The taxable capital gain on the sale is restricted to $150,000 (1/2 x $400,000 - $100,000) by the filing of the election. This taxable capital gain is eliminated by claiming the capital gains deduction.

The owner receives an annual salary of $5,000 (equal to his exemptions) plus an annual repayment of his debt, equal to the net cash flow in the corporation.

The minimum tax, Canada Pension Plan and surtaxes can be ignored.

	No Incorporation	Company
Farm profits	$ 60,000	$ 60,000
Salary to owner	N/A	(5,000)
Net income	60,000	55,000
Tax cost	21,200	12,700
Net income after tax	$ 38,800	$ 42,300
Annual cash flow to owner		
Profit	$ 38,800	
Salary		$ 5,000
Repayment of debt		42,300
	$ 38,800	$ 47,300
Difference in annual cash flow		$ 8,500
Number of years before debt is repaid ($400,000 / $42,300)		9 approx
Total potential deferral of tax (9 x $8,500)		$ 76,500

Note

1. A plan of this nature should never be implemented without assessing the implications of the alternative mimimum tax (see Chapter 5).

(c) Potential Double Tax

When a taxpayer transfers property to a corporation on which there is an accrued gain to the date of transfer, and an election is filed so that the transaction is completed on a "rollover basis", there is a possibility that the accrued gain will be subject to a double tax. It will be taxed in the corporation when the corporation disposes of the property and it will be taxed a second time when the taxpayer or his heirs dispose of the shares that were issued by the corporation in exchange for the property.

As a practical matter, this is not usually viewed as a significant problem for the farmer because the shares of a family farm corporation (as defined in the Income Tax Act) can be transferred from one generation to the next on a rollover basis. If the farm is to be sold in the near future or a significant portion of the shares issued by the corporation for the transferred property are to be redeemed in that period, the farmer's adviser should give more attention to this matter. In the latter situation, there is not likely to be a serious problem if the redemption is to be financed out of profits earned after the formation of the company.

(d) Sales Tax

Provincial sales tax should not be a significant concern because the majority of the farmer's assets will be exempt from tax. However, the tax could still apply to automotive equipment and certain other assets unless the farm is transferred to a new corporation, immediately after its incorporation. Generally, it will be necessary for the farmer, his spouse (or the family partnership, if it is transferring assets to the corporation) to own all the shares in the corporation (regulations 3-14 and 3-15 of the Social Service Tax Act).

(e) Need for professional advice

It is extremely important for you to receive advice from a lawyer and a qualified accountant before incorporating your farm and setting up your estate plan. One or both of these individuals should be thoroughly experienced in tax matters. This advice should be obtained well in advance of the transaction.

The transaction will have to be structured carefully so that it fits within the rules in the Income Tax Act dealing with "rollovers" to corporations. A special income tax election will have to be filed with Revenue Canada within prescribed time limits.

Your advisor may feel it is necessary to obtain an advance income tax ruling from Revenue Canada to avoid the possibility of there being any adverse tax consequences. He is more likely to consider this possibility if conditions are to be attached to certain classes of shares issued by the corporation that will restrict the right of the holders to redeem them in certain situations. At a minimum, your advisor will want to determine what Revenue Canada's current assessing policy is - because it changes from time to time.

The need for care cannot be over-emphasized. If the transaction is structured incorrectly, you could be exposed to a tax penalty.

CHAPTER 7

LIFE INSURANCE

Introduction

Life insurance can play a useful role in your estate plan provided your insurance needs are correctly identified and the product you buy meets those needs. Unfortunately, this is easier said than done because there are many different insurance products available and some are considerably more competitive than others.

In assessing your insurance needs, you will have to rely quite heavily on the advice you receive from your professional advisors such as your accountant, lawyer, government agricultural representatives and, most important, your life insurance agent. Insurance agents can be divided into two classifications; those who act as brokers and represent several insurance companies and those who represent only one company.

Basically, there are two types of insurance available - term insurance and permanent insurance. Term insurance is usually cheaper because it pays only in the event of the death of the insured person and there is no savings element. The policy is renewable every year or every five years and the premium is usually adjusted at each renewal date in accordance with a schedule that is known when the policy is entered into. As the individual gets older, the premiums increase. In the latter years of your life, term insurance becomes very expensive.

If the policy has a guaranteed renewal clause, it may be renewed without a medical examination. If it has a conversion clause, it may be converted into permanent insurance even though you may become uninsurable.

The most important aspect of term insurance is that it is not permanent. It has to be renewed and it will only be of benefit if the policy is in force when you die. If your health deteriorates and you become uninsurable without having a guaranteed renewal clause, your policy will terminate. In the past, term insurance policies were not normally available beyond the age of 65. Now there are a number of products on the market that are available beyond that age.

It is possible to buy certain types of term insurance through a group plan. The most common example is mortgage insurance that is often available through banks, credit unions or other financial institutions. Group insurance may also be available through certain farm producer groups.

Permanent insurance continues its coverage through to your death; it cannot be cancelled by the insurance company except through the non-payment of premiums and it does not stop when you reach the age of 65 or 70. This type of insurance can be looked upon as "term for life". The premium for this type of policy will be higher than term insurance because the insurance company knows it will have to pay the sum insured.

A portion of the insurance premiums paid under a permanent insurance policy is credited to a "reserve" by the insurer. Over the life of the policy, this reserve (or cash value) will increase to the amount insured under the policy. If the policy is cancelled or surrendered before maturity, you are entitled to the accumulated cash value of the policy. In addition, you can usually borrow against the reserve provided you are prepared to pay interest to the insurer. When you die, the amount paid out under the policy will be reduced by any outstanding loans.

Participating insurance policies allow you to participate in the investment performance of the life insurance company. Naturally, the premiums are higher. Your participation is received in the form of dividends that can be received in cash, or applied to current premiums or used to purchase additional insurance.

Insurance companies have developed policies that pay-out only on the death of the survivor of a husband and wife. This is a useful product because very often a family will not need liquid funds to pay income taxes or to finance bequests to children until both parents are dead. Depending on the circumstances, this type of policy can be considerably cheaper than a conventional one that is payable on the death of one of the parents.

Use of Insurance

Life insurance has several possible uses in your estate plan. It may be purchased for one or more of the following reasons:

1. To provide coverage on farm bank loans.
2. To fund a buy-sell agreement between unrelated partners in a partnership or shareholders of a corporation. This funding may also be desirable in situations where brothers and sisters carry on a farming business together.
3. To provide cash to the estate of the survivor of you and your wife which can be used to fund bequests to non-farming children.
4. To provide income to the surviving spouse through the investment of the insurance proceeds.
5. To provide liquid funds to your estate to enable it to pay income taxes (if any) and estate clearance costs such as solicitor's fees.

Tax Implications

The tax treatment of insurers and their products has undergone much change over recent years. A detailed discussion of the current rules is beyond the scope of this publication because they are too complicated.

There will be no tax payable by your estate in respect of the proceeds from a term insurance policy. There will also be no tax in respect of the pay- out of an "exempt" permanent policy, provided the pay-out occurs only as a result of your death. Essentially an "exempt" policy is one that is bought for protection purposes rather than as an investment. Generally, all policies acquired before December 2, 1982 will be considered to be "exempt" unless they are changed after that date. Most policies acquired after December 1, 1982 will be "exempt" too.

The pay-out under a "non-exempt" permanent policy may give rise to tax as will a payment under any permanent insurance policy that you cash in during your lifetime. The amount that is included in income is the excess of the amount received under the policy over the adjusted cost base of the policy.

If you acquire a non-exempt policy you will be taxed annually (or every three years) on the investment income that accrues within the policy even though this income might not be received until the policy pays out.

Policy loans are treated for income tax purposes as being proceeds of disposition of the insurance policy and an amount will be included in income to the extent that the loan exceeds the adjusted cost base of the policy.

Generally, premiums paid on life insurance policies are not deductible for income tax purposes. However, taxpayers who are required to purchase term insurance as collateral for their business loans are able to deduct the insurance premiums in most situations. The requirements that must be met are set out in Revenue Canada's Interpretation Bulletin IT-309R.

Conclusions

Because of the complexity of the subject and the multitude of products on the market, you will need the advice of an insurance agent. Ideally, the agent will be able to compare the products of several different insurers so that you get the "best deal". You must satisfy yourself that you need the product being offered and the agent has recommended the best plan.

CHAPTER 8

IMPLICATIONS OF FAMILY LAW REFORM

Introduction

Approximately four out of every ten marriages end up in the divorce courts these days so it is important that you have some understanding of the provisions of the B.C. Family Relations Act. This Act sets out the manner in which a family's assets are divided between a husband and wife in the event of a marriage breakdown. Because it can have a significant effect on an estate plan you should ask your solicitor for advice when he prepares or updates your will.

The basic premise of the Act is that marriage is an economic partnership through which each spouse is entitled to share in the financial rewards of the other's efforts. The Act establishes a category of assets called "family assets" that must be divided between the spouses in the event of a marriage breakdown.

The classes of assets that are defined as being "family assets" are as follows:

(a) any property owned by a spouse and ordinarily used for family purposes; and

(b) assets owned by a spouse and used for business purposes, if the spouse who does not have an interest in the property has made a contribution in money or money's-worth to the acquisition of the asset.

Category (b) above is extremely broad because a contribution towards the purchase of the property is deemed to include any savings realized by the family through a spouse's effective household management or child - rearing responsibilities. In many cases, it will be difficult to argue that a spouse has not made at least some contribution in this sense to all the assets acquired during marriage. This will be particularly true on a family farm where the wife not only maintains the home but usually helps with farm chores as well. As a result, virtually any type of asset can constitute a family asset for purposes of the Family Relations Act.

Based on recent court decisions, it appears that a spouse can acquire the right to share in a particular property even though it might have been owned by the other spouse before marriage or might have been obtained by that spouse from his or her parents. This is particularly true where the marriage is of reasonably long duration - say ten years.

The right of a spouse to receive a share of the "family assets" arises when there is a "marriage breakdown". This term is defined in the Family Law Reform Act as including the following:

1. The making of a separation agreement;
2. The issue of a judgement of the Supreme Court that the spouses have no reasonable prospect of reconciliation;
3. The making of an order for dissolution of the marriage or judicial separation; or
4. the making of an order declaring the marriage null and void.

Tax implications of the division of family assets

As mentioned in Chapter 4, the Income Tax Act contains provisions that enable certain property to be transferred between spouses on a rollover basis unless the transferor spouse elects to not have the rollover rules apply. These provisions also apply where there is a division of property pursuant to a provincial statute such as the Family Relations Act. Despite the existence of these rules, however, the division of family assets can result in income tax problems. The problems arise because either the particular asset is not covered by the spousal rollover rules or the court directs that the asset be transferred to a person other than a spouse.

Looking at the position of a farmer, income tax problems can arise in the following situations:

1. Where quota is transferred to the farmer's spouse it will usually be treated as having been sold at fair market value. One-half of the proceeds will generally be included in the farmer's income. If, as part of the settlement, the farmer ceases to carry on farming and his spouse commences to carry on the business, there will be a rollover for income tax purposes.
2. Livestock and other inventories transferred to the farmer's spouse (or his children) will also generally be treated as having been sold at fair market value.
3. Land and buildings transferred to a trust for the benefit of the farmer's wife will not transfer on a rollover basis unless the provisions of the trust meet the requirements of the Income Tax Act. If the trust is imposed by a court order, there is some question as to whether the rollover will apply in any event because the trust may not be regarded as having been created by the farmer. This is required under the Income Tax Act.

Attribution Rules

As a general rule, where property is transferred between spouses in a transaction other than a fair market value purchase, income and capital gains earned thereon are attributed to the transferor spouse. Similar rules apply where property is transferred to a child under age 18 except that generally, they do not apply to capital gains realized on the disposition of the transferred property. These provisions are discussed in more detail in Chapter 5.

Where property is transferred to a former spouse the attribution rules do not apply. Where the transfer is made to a spouse who commences to live apart by reason of a breakdown in their marriage, the rules are as follows:

a) Income from the transferred property - Income ceases to be attributable after the spouse commences to live separate and apart.

b) Taxable capital gains from the sale of the transferred property - Taxable capital gains cease to be attributed after the spouse commences to live separate and apart provided the individual who transferred the property files an election, completed by both spouses, to the effect that the attribution rules shall not apply. This election must be filed with the return for the year in which the separation occurs.

Planning

In some cases, a straight-forward division of the family assets of a farmer will result in a significant tax liability and it will be in the interests of both parties to see if they can restructure the distribution so that the tax is deferred.

A person who is contemplating marriage, perhaps for the second time, may want to review with his or her solicitor the extent to which the provisions of the Family Relations Act can be avoided or limited by entering into a marriage agreement. Discussing this sort of agreement with a "bride or bridegroom-to-be" may not be easy because it is tantamount to saying that I love you but ...... However, these agreements are being used more often these days.

Where property is being transferred by parents to their son or daughter and there is some concern over the Family Relations Act, the parties may want to make it abundantly clear in the documents that the transfer is being made to their child and not to his or her spouse. This may have the effect of reducing the spouse's claim on the property being transferred if there is a marriage breakdown at some future time. This may not be particularly difficult if the child's spouse is not a party to the arrangement. If, however, the family attempts to take this one step further and request that the spouse become a party to the arrangement it would be necessary for the spouse to obtain independent legal advice and a major family problem might arise.

CHAPTER 9

ADMINISTRATION OF THE ESTATE

Introduction

The administration of an estate involves the collection, management, and realization of the property of a deceased person and the distribution of that property to the beneficiaries of the estate. It will be carried out by the deceased's executor (or administrator if there is an intestacy) with the help of a solicitor.

As discussed in Chapter 2, your executors will normally include your wife and one or more of your children. If they are not able to fully understand your business affairs the family's accountant or solicitor might be involved as well.

The administration of your estate may take up to six months, or even longer, because there will be a substantial number of assets to locate, value and transfer to the intended beneficiaries. The job will be somewhat easier if the farm is incorporated because the distribution of the farm property will be accomplished by simply recording the transfer of the shares in the company's share records.

You should look upon the administration of your estate as the final test of your estate plan. You will not be around to see if your plan passes the test but your family and friends will. If your planning is effective, your executors' job will be made considerably easier.

The steps you can take to help your executor are as follows:

1. Ensure that all members of your immediate family are aware of, and in agreement with, the provisions in your will and know where the will is kept.
2. Ensure that your will takes into account all changes in your business and family situation, it is expressed clearly and provides for the disposition of your assets in an orderly and reasonable manner.
3. Ensure that the executor is aware that he has been named and that there are alternates in the event that he is unable or unwilling to act.
4. Maintain a listing of major assets and liabilities and ensure that your wife and children know where it is kept. This listing should include the street address or legal description of real property owned, a description of the major farm equipment and its location, bank account numbers and details on insurance policies, etc. Attached to this

publication is a blank checklist that may be cut out and used for this purpose.

5. Keep valuable papers such as land title documents, mortgages, agreements for sale, share certificates, bonds, savings account pass books and insurance policies in a safe place and ensure that your wife and children know where they are.

Role of the personal representative

The executor (or the administrator if there is an intestacy) has significant responsibilities placed upon him. He will usually delegate much of the work to a solicitor or accountant, but ultimate responsibility remains with him.

His initial responsibility will be to make appropriate funeral arrangements and to request a solicitor to apply to the court for Letters Probate. This document confirms the validity of the will and the executor's appointment. If there is no will, an administrator would apply for Letters of Administration. If the executor appointed in the will is unwilling to act and there are no alternates, an administrator would again apply for Letters of Administration with Will Annexed.

An administrator may be required to post a bond with the court. This requirement can be dispensed with in special circumstances.

In obtaining Letters Probate (or Letters of Administration) the personal representative will determine the nature and value of the assets and liabilities of the deceased. After, he will advertise for information on debts that he is not aware of, calculate and pay the income tax liability of the deceased and the estate, obtain a clearance certificate from Revenue Canada evidencing that all income taxes have been accounted for, obtain the consent of the beneficiaries or pass the accounts through court, convert the assets to cash and distribute the proceeds or, if empowered to do so, distribute them "in specie" (see Glossary), set aside the assets or funds which are to be retained, pay all legal fees and other costs of settling the estate and, finally, account to the beneficiaries, and to the court if required to do so, for all actions in connection with the administration of the estate.

Under the Trustee Act, the personal representative is allowed to receive up to 5% of the gross value of the assets of the estate as compensation for the services he performs.

Role of the solicitor

The solicitor's function is to act on behalf of the executor or administrator. He will normally advise the personal representative on legal matters affecting the administration of the estate, prepare the application for Letters Probate or Letters of Administration, prepare the documents required in connection with the conversion of assets to cash or the distribution of property to beneficiaries, and assist in the preparation of the financial accounts of the personal representative.

Property that does not become part of the estate

Certain property passes directly to your beneficiaries, rather than through your will, and does not, therefore, become part of your estate. The distinction is significant because property treated in this manner cannot be seized by your creditors.

Assets that do not become part of your estate include the following:

- property held in a joint tenancy arrangement (see Chapter 3);
- proceeds from life insurance policies which have named beneficiaries; and
- proceeds from a registered retirement savings plan which has a named beneficiary.

Tax liability of the deceased

As discussed in Chapter 4, a deceased person is deemed to have disposed of most of his assets immediately before his death and the resulting taxable capital gains, allowable capital losses, recaptured depreciation, etc. are included in his final tax return. Because of the new capital gains deduction and the extensive rollovers available to you in respect of property bequeathed to a spouse, a spouse trust or a child, this deemed disposition will not usually result in a significant tax liability.

The livestock, feed inventories and accounts receivable of a cash basis farmer that are bequeathed to a beneficiary are given special treatment under the Income Tax Act. These properties, together with certain other assets such as uncashed bond coupons, (described in the Income Tax Act as "rights or things") may be included in the deceased's final return or in a separate return on which a second set of personal exemptions is claimed. If the rights or things are distributed to the beneficiaries within one year of death or within 90 days after the mailing of the Notice of Assessment for the year of death, whichever is later, the value of the rights or things are included in the beneficiaries' income in the year in which they dispose of the properties. These rules, in effect, provide a rollover for livestock, inventories and accounts receivable bequeathed by a farmer.

To the extent possible, the personal representatives will want to fix the deceased farmer's income in the year of death so as to utilize his unabsorbed losses, charitable donations and tax credits, and to keep his income taxes to a minimum. They will need to take into account the amount of the livestock adjustment added to the farmer's income in the year preceding the year of death. This amount will be deductible in the final return together with any unused basic herd deduction.

As a result of the new capital gains deduction, and the ability of executors to select the values at which certain farm assets are deemed to be disposed of for tax purposes when they are transferred to a child (see Chapter 4), the personal representatives of a deceased person now have an added responsibility when they arrange for the preparation of the deceased's final return. Assuming the will empowers them to do so, the personal representatives will generally want to select the highest permitted transfer values that will not result in taxes being paid by the deceased's estate. By maximizing these transfer values, the deceased's children will have a higher cost for income tax purposes and when the farm is ultimately sold there will be less possibility of income tax applying.

The farming assets which are eligible for this treatment are the "qualifying farm properties" (see Glossary) except quota. The transfer value selected for each asset must be between its "cost amount" (see Glossary) and its fair market value. In determining the optimum transfer value the personal representatives must take into account not only the deceased's unused capital gains deduction but also the possibility of the deceased being subject to the alternative minimum tax (see Chapter 5).

If a sole proprietor or a partner in a farming business dies after the fiscal period of the business but before the end of the calendar year in which the fiscal period ends, the personal representative may file a separate return in respect of the business income for the period commencing with the end of the fiscal period to the date of death. The alternative minimum tax rules will not apply to the income reported on this separate return nor to the income reported on a separate "rights or things" return (see page 61).

If a farmer had sold farm property during his lifetime and had been carrying forward a capital gain reserve in respect of the unpaid sale proceeds, one-half of the reserve must be included in his final return as a taxable capital gain. Similarly, if the farmer had been carrying forward an income gain reserve (e.g. arising from the sale of cattle by an "accrual basis" farmer), the reserve must be included in his final return as income. If these debts receivable on which the reserves were being claimed are bequeathed by the farmer to his spouse, the reserves flow through to her provided a special election is filed with Revenue Canada.

If the farmer realizes allowable capital losses in the year of death, or in the preceding year, they can generally be deducted from income from any source, without restriction. Ordinarily, these losses, if incurred after May 23, 1985, may only be deducted from taxable capital gains. If the farmer has claimed the capital gains deduction in any year, the allowable capital losses which can be deducted from income other than capital gains is reduced by the amount of the deduction. To illustrate, let us assume that a farmer dies in 1986 and realizes allowable capital losses of $15,000 in that year. If he has never claimed the capital gains deduction, these losses may be offset against any income in 1985 or 1986.

If however, the farmer claimed a $10,000 capital gains deduction in 1985, only $5,000 of his allowable capital losses could be offset against other income in 1985 or 1986.

If the farmer is subject to the minimum tax in his final return, the excess of this tax over his regular tax may be deducted from his regular tax liability for the three years preceding the year of death. The carry-back of this minimum tax cannot be used to reduce the farmer's tax liability below his minimum liability in these years.

An illustration of the impact of the minimum tax is shown in Appendix 6.

Gifts made to registered charities in the year of death, or bequeathed to them in the farmer's will, are deductible in the farmer's final return or in the return for the previous year. The amounts deductible cannot exceed 20% of the farmer's income in those years.

Filing of returns and payment of tax

The tax return for a year ending prior to the date of death must be filed within six months of the date of death. The return for the year of death (the final return) must generally be filed by the later of six months following the date of death or April 30 of the taxation year following the date of death. To illustrate, if an individual died on January 31, 1986 and had not filed his 1985 return before death, his personal representatives would have to file his 1985 return by July 31, 1986 and his 1986 return by April 30, 1987.

Where a spouse trust is created under the deceased's will, the final return may be filed up to eighteen months after the date of death. If there is a separate return for rights or things, it must be filed by the later of one year from the date of death and the date that is ninety days after the mailing of the Notice of Assessment in respect of the final return.

The estate itself must also file a return. If the administration is completed in less than a year there will be only one return covering the period of administration. If it extends beyond one year, a separate return will have to be filed for each "taxation year". The "taxation year" of an estate is the period for which the accounts are ordinarily made up. Usually, the taxation year of the estate will end on the anniversary of the date of death or on December 31. The taxation year cannot exceed twelve months and after the year-end has been established it cannot be changed except with the permission of Revenue Canada.

Ordinarily, the tax owing by the deceased is due on or before the date that the return has to be filed. However, to the extent that the deceased has amounts included in his income in respect of rights or things or in respect of taxable capital gains or recaptured depreciation arising from the deemed disposition of capital property owned at death, the personal representative can elect to pay the tax in up to ten annual instalments. The government charges interest on the unpaid tax.

Clearance certificate

It is important that the personal representative obtain a clearance certificate from Revenue Canada before distributing the deceased's estate to the beneficiaries. If he fails to do this he will become personally liable for the unpaid taxes, interest and penalties. There are separate clearance certificates for the taxation years of the deceased and the estate. The procedures to be followed are discussed in Revenue Canada's Interpretation Bulletin IT - 282R and Information Circular 82 - 6.

Accounting records

Except where the personal representative is the sole beneficiary, the personal representative must keep accurate accounts summarizing his administration of the estate. The accounts will generally include an inventory of the original estate assets, details of all money received and disbursed and a summary of the assets on hand. The supporting books and records should be maintained until all clearance certificates have been issued.

CHAPTER 10

COMMON ESTATE PLANNING PROBLEMS AND THEIR SOLUTIONS

Providing for the non-farming children

One of the most common estate planning problems of the farmer today is how does he provide for his non-farming children? The problem is particularly acute for the farmer who has relatively few "off-farm" investments and would like to transfer his farm intact to the children who are involved in the business.

The farmer's problem has been made worse by the dramatic increase in the level of investment in the average farm in the last ten years. These higher farm values have obliged farmers to increase their bequests to their non-farming children, and because these bequests are funded by the income from their businesses, the future financial viability of the farms is sometimes placed in jeopardy.

Information released recently by one of the chartered banks in Canada illustrates the magnitude of the problem. In 1971, the average capital per farm was $66,000 whereas in 1981 it was $410,000. This represents a 621% increase over 10 years. If the cash flow from the average farm had increased at the same rate, the problem would not be as significant. But, unfortunately, it has not.

A development which compounded the problem was the introduction of tax on capital gains in 1971. Because of the substantial increase in asset values that have occurred in the past decade, many family farms now have significant accrued capital gains.

In approaching the problem, you must first consider the manner in which your children will share in your assets. It will not necessarily be an equal share, but it should be an equitable one. Whatever arrangement is decided upon must provide you with the retirement capital you need.

Some farmers have achieved their objectives by the purchase of insurance. The manner in which this might be done can best be illustrated by a hypothetical example.

Assume the following:

(1) A farmer and his wife carry on business in partnership.

(2) The total adjusted cost base and fair market value of their interests in the partnership are $300,000 and $1,200,000 respectively.

(3) They have a term insurance policy for $400,000.

(4) They have two sons who will carry on the farm, and two daughters who are not involved on the farm.

(5) They need $600,000 of retirement capital.

In this situation, the parents might proceed as follows:

(1) They might transfer their partnership interests to their sons during their lifetime for $600,000. This would precipitate a taxable capital gain of $150,000 (1/2 x $300,000); however, on the assumption that the farmer and his wife had not previously used their capital gains deduction, (and that the minimum tax rules did not present a problem) there should be no taxes payable. The children would have received a gift by acquiring their partnership interests at less than fair market value but this would not result in a tax.

(2) They might provide in their wills that after the death of the survivor of them, the residue of their estates shall be divided among all of their children in a manner that will recognize the earlier gift to their sons. As the sons will have inherited a portion of their parents' tax liabilities and may have contributed value to the farm, the gift may be looked upon as being something less than $600,000 - perhaps $400,000. On this basis, the first $400,000 of the residue of the estate (the insurance proceeds) would be distributed to the daughters and the balance would be distributed equally to all of the children.

To evaluate this option, it is necessary to take into account the cost of insurance. Unfortunately this is difficult to do because there are a great many insurance products available and the premiums thereon are affected by the insured's personal circumstances. However, in order to provide the reader with a very general idea of what the cost might be on a $400,000 policy, certain information provided by an insurance broker in 1984 from a review of the term insurance products then offered by the major insurers is summarized below. The figures quoted were based on the assumption that the insured person was a male, was in good health and was a non-smoker.

Age At Which Policy Taken Out	Estimated Annual Premiums: Regular Term Insurance (Note 1)	Estimated Annual Premiums: Level Term Insurance to Age 100 (Note 2)
40	$ 750	$ 1,950
50	$ 1,700	$ 4,050
60	$ 4,000	$ 7,400

1. The regular term insurance is normally available only to the age of 65 or 70. The premiums noted are those applying in the initial five year period only. Premiums in subsequent renewal periods are higher.

2. The premiums noted for the Level Term Insurance to age 100 apply only for the first five years. In the subsequent periods there may be an increase or reduction depending on the future direction of interest rates.

   The premiums for this type of policy are considerably higher than ordinary term insurance in the initial years because there is permanent protection. In other words, assuming that premiums are paid until death, it is virtually certain that the insured's family will receive the insurance proceeds. With ordinary term insurance the insured's family will receive insurance proceeds only if the policy is still in force at the time of death (e.g. the insured dies before the age 65 or 70, as the case may be). Ordinary term insurance becomes expensive at that age with the result that most policies are allowed to lapse before death.

   If a comparison of premiums for regular term insurance and level term insurance to age 100 is made over a longer period (say fifteen years) and an appropriate discount factor is applied to premiums payable in the future, the total cost of the two policies will be considerably closer than is indicated by the above figures.

Some farmers will not want to purchase insurance, or will be unable to, and will have to find other methods of realizing their estate planning objectives. One possibility would be to sell their farm property to their farm children at a value that will not only create sufficient retirement capital but will also provide sufficient non-farming assets for the non-farming children. This will often require a sale at an amount that is in excess of the farmer's tax cost. Whether income tax will be payable will be determined by the amount of the unused capital gains deduction and the application of the rules dealing with minimum taxes.

An approach to this problem that has been used in the past is to bequeath the farm to the farm child and to place a mortgage on the property before distributing it to him, thereby creating some non-farming assets that can be transferred to the non-farming children. If the mortgage is payable to the non-farming children (rather than to a financial institution) there will be complete flexibility as to the payment of interest and principal. The repayment terms would not have to be the same as those found in a normal commercial loan but, presumably, they would have to be such that all children were treated equitably.

As mentioned on page 30 of Chapter 4, this is no longer an appropriate method of dealing with the problem. A better approach is to arrange for the farming child to have the option of purchasing certain farm assets from the estate. If interest is payable on the purchase price, it will be deductible for income tax purposes.

The farmer might vary the sale transaction discussed on the previous page by selling only his operating assets to his farming children and leasing his land and buildings to them. After his death, the real property would perhaps pass to his non-farming children and they would be bound by the terms of the lease. If successful, the transaction would provide the farmer with sufficient retirement income and would "equalize" the value of gifts made to all of his children. The problem with this arrangement is that often there are disagreements between the children as to who should be responsible for the improvements to the farm and who should they revert to at the end of the lease period. As well, land and buildings have traditionally experienced greater inflationary gains than most operating assets. Since the farming child will not share in these gains he is sometimes less prepared to maintain the property in the way that he would if it were his own.

Care would have to be taken over the wording of the lease agreement. If it gave the farming children the option to acquire the land and buildings at a percentage of fair market value and the non-farming children were required to sell the property if the option was exercised, there may be a risk that Revenue Canada would argue that the property does not vest indefeasibly in the non-farming children and the rollover does not apply. This is a matter that the farmer's tax advisor would have to pursue.

In situations where there are several non-farming children and only one or two farm children, it will be considerably more difficult to provide for all children equitably without selling some of the farm assets. Even here, however, it may be possible to preserve the farm with the use of a corporation. The manner in which the corporation might be used is discussed in Chapter 6.

Treating children equally or equitably

There will be many situations in which an equitable distribution among the children will not necessarily be an equal one. The child who decides to stay on the farm may give up certain advantages enjoyed by his brothers and sisters. He may also make a considerable contribution to the farm during his parents' lifetime for which he does not receive adequate compensation. In recognition of this, the farmer may wish to transfer additional property to him.

Whenever this happens it is important that the matter be discussed openly with the family. All of the children must understand the reasoning behind the distribution so that there are no recriminations in later years.

Rental land

Land and buildings that are rented to a family farm corporation or to a family farm partnership are now eligible for a tax-deferred rollover when transferred to a child. However, if the property is rented to an unrelated person, the rollover rules will not apply. This is perhaps not too serious in some cases because the property will nevertheless qualify for the capital gains deduction if it was farmed for at least five years by the owner, his spouse or any of his children.

If the lack of a "rollover" is serious, the owner might consider converting the property to one that is eligible for the "rollover" by putting a custom work contract in place.

Unfortunately, there is a great deal of misunderstanding as to what this type of arrangement constitutes. Some people assume that because the document is called a Custom Work Contract "all is well". That is untrue.

The custom work contract is an arrangement that puts the owner of the land into the business of farming. It will not do this if it is simply a crop share rental arrangement.

The method of determining whether or not there is a valid custom work contract is to ask, "how much will have to be paid if there is a complete crop failure?" If the answer is that the owner of the land would have to pay only the property taxes, the arrangement will not be a custom work contract.

Risk is the key factor. Under a custom work contract, the custom operator undertakes the various farming operations from seeding and tillage through to the harvesting operations in exchange for compensation on an hourly or per acre basis, or perhaps a combination of the two. The land owner is responsible for all other expenses except the operating and maintenance costs of machinery. In other words, the land owner pays expenses such as seed, fertilizer, chemicals, sprays and property taxes, in addition to the custom work fees. The custom work operator is responsible for the fuel, oil, repairs, maintenance, etc. connected with the operation of the machinery. The landowner will determine which fields will be seeded and which will be summer fallowed, what crops will be seeded and which fields will be fertilized and sprayed.

Common Estate Planning Problems and their Solutions

Common problems in wills

The more common types of problems that are found in farmers' wills are as follows:

1. Providing that the property passing on death to a minor child shall be held in trust until he attains the age of majority and if he fails to attain that age, it shall be distributed to his brothers and sisters. Revenue Canada takes the position that in this situation the property does not vest indefeasibly in the minor child (because he will not receive it if he fails to attain the age of majority) and the rollover will not apply.

2. Bequeathing shares of a farm corporation to a spouse or child if there is a shareholders' agreement in which there is a provision that requires the spouse or child to sell the shares to other shareholders. Again, Revenue Canada takes the view that the shares will not vest indefeasibly because the spouse or child is required to sell them.

3. In order to provide for the non-farming children, a farmer will sometimes bequeath his operating assets to his farming children and his land and buildings to his non-farming children. Before releasing the property from the estate, the executor is usually instructed to lease the real property to the farming children at a fair rental. Revenue Canada has stated in a private technical interpretation that this will not affect the rollover provided the lease is put in place within thirty-six months of the date of death. If the lease gives the farming children the right to acquire the property at a percentage of its fair market value, Revenue Canada may not be prepared to view the property as having vested indefeasibly in the non-farming children. This is a matter that would have to be clarified with Revenue Canada.

4. Bequeathing property to a trust for a spouse where the terms of the trust do not meet all the requirements of a "spouse trust", as set out in the Income Tax Act (see Chapter 4 for requirements).

These and other potential problems are discussed in Revenue Canada's Interpretation Bulletins IT - 449 and IT - 349R.

CONCLUSIONS

Estate planning is a broad subject that is especially important to the farmer. The capital intensive nature of his business means that there is a need for a well thought-out estate plan. If he neglects this job his family may suffer considerable anguish and there may be financial penalties as well.

The good estate plan is not something that is "hashed out" on an "overnight" basis after an initial consultation with a lawyer or accountant; nor is it something that remains static except in the very latest stages of a person's life. The good estate plan is something that will probably be discussed by the family over a considerable period of time. It will incorporate the considered opinions of all members of the immediate family. The solicitor and accountant will be able to make a useful contribution in the early stages by recommending how the farmer should approach the planning process. They will also be able to advise him of the estate planning tools at his disposal.

The good estate plan will evolve over time. It will be flexible during the period that the children are growing up and deciding what they want to do. It will ensure that the farmer is well provided for during his retirement and that all of his children are treated equitably.

The time devoted to the good estate plan will be repaid many times over in the increased peace of mind of the family and the savings in taxes, estate management costs and property transfer procedures.

BIBLIOGRAPHY

Canadian Estate Planning and Administration - Mary Louise Dickson and James R. Wilson

Estate Planning for Farmers - Kim E. Johnson

Farm Business Partnerships in British Columbia, Farm Business Corporations in British Columbia and Taxation and the B.C. Farmer - Ministry of Agriculture and Fisheries in British Columbia

Income Tax Implications of the Family Relations Act of British Columbia - D.A.G. Birnie and J. Margolis

These Taxing Times - W.S. Wallace

APPENDIX 1

GLOSSARY OF TERMS USED IN ESTATE PLANNING

Adjusted cost base:	The "tax cost" that is used to determine the capital gain or capital loss realized on the disposition of a capital property. (See definition of capital property.) The adjusted cost base (ACB) of land will generally be the amount paid for it although adjustments are required in certain situations. If the land was acquired before 1972, its ACB will generally be determined by reference to its fair market value at the end of 1971. The ACB of buildings and equipment, etc. will generally be the amount paid for it. The ACB of an interest in a family farm partnership (see definition of family farm partnership) is determined by reference to the cost of the interest, the capital contributions made to the partnership, the partner's share of profits and losses and his drawings. If the partnership existed at the end of 1971 there are some extremely complicated transitional rules to take into account. The ACB of shares in a family farm corporation (see definition of family farm corporation) will generally be the amount paid for them although adjustments are required in certain circumstances. If the shares were acquired before 1972, their ACB may be determined by reference to their fair market value at the end of 1971.
Administrator:	An individual or corporation appointed by a court to administer the estate of a person who dies without making a will or the estate of a person who dies with a will, but without anyone prepared or able to act as executor.
Agreement for sale:	A sale transaction in which the seller receives the sale price over a period of time and retains title to the sold property until he receives all the payments.
Allowable capital loss:	The deductible portion (one-half) of the capital loss realized on the sale of a capital property. (See definition of capital property.)

Glossary of Terms used in Estate Planning

Attribution rules:	The rules in the Income Tax Act that require income from a property or a capital gain or loss from the disposition of a property to be included in the tax return of a person who does not own the property. These rules apply in certain situations where funds or property are transferred by an individual to his spouse or to his minor child.
Bequest:	A gift received from an individual through his will.
Block averaging:	A method of "income-averaging" that can be used by unincorporated farmers at intervals of not less than five years to reduce their income tax liability.
Buy-sell agreement:	An agreement between business partners or shareholders which sets out important matters concerning their business relationship, including the manner in which the interests of each of the partners or shareholders are to be purchased on retirement and on death.
Canada Pension Plan:	A compulsory social security programme of the federal government that provides a retirement pension and certain other benefits.
Capital beneficiary:	A person who is entitled to a share of the assets held in a trust. (See definition of trust.) The interest of a "capital beneficiary" must be distinguished from that of an "income beneficiary". (See definition of income beneficiary.)
Capital cost allowance:	The deduction that is allowed for income tax purposes in respect of the reduction in value of buildings, machinery and equipment that occurs through its use. This deduction is often loosely referred to as "depreciation".
Capital property:	A property that is acquired for investment purposes, or use in a business, that will give rise to a capital gain; and not an income gain, if it is sold at a profit. Land, buildings, machinery, equipment, shares in a farm corporation and an interest in a farm partnership will usually be capital property to the farmer.
Clearance certificate:	A certificate to be obtained from Revenue Canada by the personal representative of a deceased

Clearance certificate (continued):	taxpayer before distributing the assets of the estate. Failure to obtain the certificate can make the personal representative personally liable for the deceased's outstanding tax liability.
Codicil:	An addendum to a will.
Cost amount:	A term meaning the "tax value" of a particular property. The "cost amount" of typical farming properties is as follows:

Land	- its adjusted cost base (see definition of adjusted cost base);
Buildings, equipment etc., depreciated on the reducing balance basis	- its undepreciated capital cost (UCC) for tax purposes (see definition of UCC);
Buildings, equipment etc., depreciated on the straight line basis	- its adjusted cost base (see definition of adjusted cost base);
Intangible assets such as quota	- the amount of the cumulative eligible capital (see definition);
Interest in a family farm partnership	- its adjusted cost base (see definition of adjusted cost base);
Shares in a family farm corporation	- their adjusted cost base (see definition of adjusted cost base).

Cumulative eligible capital:	The amount of a taxpayer's undepreciated expenditures made after 1971 on intangible assets such as quota. (These intangible assets are called eligible capital properties - see later definition.)
Distribution tax:	The 12 1/2% tax payable by private companies on dividends paid out of income that has been taxed at the low corporate rate of 23%. This tax was repealed, effective January 1, 1987.

Glossary of Terms used in Estate Planning

Earned income:	The income that may be contributed (within limits) to a registered retirement savings plan.
Eligible capital property:	Intangible properties (such as quota or goodwill) acquired in connection with a business. One-half of the expenditure on such properties is added to the taxpayer's cumulative eligible capital and depreciated for tax purposes.
Family assets:	The assets which, under B.C. Family Law, must be divided between a husband and wife in the event of a marriage breakdown unless the court otherwise orders.
Family farm corporation:	A farming corporation that meets certain tests in the Income Tax Act so that its shares may be transferred from one generation to the next on a "rollover basis". (See definition of "rollover".) The corporation must use all or substantially all of its assets in carrying on a farming business in Canada and the farmer, his spouse or one of his children must be actively involved in that business. A holding company will qualify as a family farm corporation in certain situations.
Family farm partnership:	A farming partnership that meets certain tests in the Income Tax Act so that the partners' interests may be transferred from one generation to the next on a "rollover basis". (See definition of "rollover".) The partnership must use all or substantially all of its assets in carrying on a farming business in Canada and the farmer, his spouse or one of his children must be actively involved in that business.
Family Relations Act:	The legislation in British Columbia that deals with the division of assets that occurs when there is a marriage breakdown.
Formal will:	A document, usually type-written, setting out an individual's wishes regarding the disposition of his assets after his death, signed by the individual and two witnesses in the presence of each other.
Forward averaging:	A method of reducing tax in years of high income by averaging the excess income over future years.
Guaranteed renewal clause:	A clause in a term insurance policy requiring the insurer to renew the policy even when the insured's health deteriorates. (See definition of term insurance.)

Glossary of Terms used in Estate Planning

Income beneficiary:	A person who is entitled to share in the income earned on assets held in trust. (See definitions of trust and capital beneficiary.)
Income-splitting:	An arrangement which has the effect of transferring income from a "high tax-rate" person to a "low tax-rate" person so that the overall tax liability is reduced.
"In specie":	A personal representative can distribute assets from an estate "in specie" (e.g. in their present form) or, if authorized by the will, can sell them and distribute the cash proceeds.
Inter-Vivos:	An "inter-vivos" transaction of a particular person is one carried out during his lifetime rather than after his death.
Intestate:	The term used to describe the estate of a person who dies without leaving a will.
Issue:	All persons descended from a common ancestor.
Joint tenancy:	A form of co-ownership under which the interest of a deceased person automatically passes to the co-owners.
Letters of Administration:	A court-approved document giving a person the right to administer the estate of a person who dies without leaving a will.
Life annuity:	An annuity that is payable throughout the life of the annuitant. There may be a guaranteed minimum pay-out period or a "joint and last survivor option" under which payments continue until the death of the survivor of the taxpayer and his spouse.
Life estate:	An interest in property limited in time to the life of a particular person.
Old Age Security:	The "old age" pension payable by the federal government to persons who meet the age and residence tests.
Permanent insurance:	A type of life insurance that continues its coverage through to the death of the person insured. (See definition of term insurance.)
Per stirpes:	The basis of dividing the share of a deceased beneficiary amongst his descendants according to

Per stirpes (continued):	their relationship to the deceased. (e.g. A father dies and is survived by his son and two children of his deceased daughter. On a per capita basis each would receive one-third whereas on a per stirpes basis the son would receive one-half and each grandchild would receive one-quarter.)
Preferred Beneficiary Election:	An income tax election filed by the trustee and beneficiary of a trust which "deems" certain income that is received and retained by the trust to be the income of the beneficiary.
Principal residence:	An owner-occupied home that can be sold at a profit without resulting in tax.
Qualifying farm property:	A term used in this book to describe the farming assets that can be transferred by an individual to his child on a tax-deferred basis. The property is: - land; - buildings, equipment, etc. depreciated for income tax purposes on the reducing balance basis; - eligible capital property (e.g. quota) (see definition); - shares in a family farm corporation (see definition); and - an interest in a family farm partnership (see definition). The land, buildings and equipment, etc. must be owned by the individual and must be used by him, his spouse, or any of his children in the business of farming in Canada, immediately before the transfer. Quota must also meet this test if it is transferred to the child during the individual's lifetime.
Registered Retirement Income Fund:	A fund administered by a financial institution and registered with Revenue Canada, into which an individual can transfer his accumulated registered retirement savings plan monies on retirement. The individual would then receive amounts from the fund, computed in part on a formula basis, throughout the remainder of his life.

Glossary of Terms used in Estate Planning

Registered Retirement Savings Plan:	A plan offered by a financial institution and registered with Revenue Canada that allows an individual to save for his retirement by contributing amounts to the plan each year. The amount contributed is deductible from the individual's income and compounds free of tax while it is held in the plan.
Reserve:	A deduction that may be claimed for income tax purposes in a particular year where a taxpayer sells a property and the sale price is payable over a period that extends beyond the end of that year.
Rights or things:	The term given to items such as livestock, inventories and accounts receivable of a "cash-basis farmer" that are given special treatment in the final income tax of a deceased individual.
Rollover:	The term that is used to describe a "tax-deferred" transfer of property in which the person acquiring the property inherits the transferor's tax cost.
Siblings:	Brothers or sisters.
Small Business Bond:	A special type of low-interest loan made to a business that is in financial difficulty for which a special election has been filed with Revenue Canada. The interest on the bond is not deductible by the business nor taxable to the lender.
Sole proprietorship:	A business carried on by an individual.
Spouse trust:	A trust established by a taxpayer for the benefit of his spouse. Property transferred to such a trust is deemed to be disposed of for income tax purposes on a "rollover basis" if certain requirements are met.
Taxable capital gains:	The taxable half of the profit realized on the disposition of a capital property. (See definition of capital property.)
Tenancy in common:	A form of co-ownership under which the co-owner's interest can be gifted, sold or bequeathed to any person.
Term annuity:	An annuity payable for a specified number of years.

Glossary of Terms used in Estate Planning

Terminal loss:	The undepreciated capital cost (UCC) of a particular fixed asset class that can be deducted from income when all assets of that class have been disposed of. (See definition of UCC.)
Term insurance:	A type of life insurance that is usually less expensive than other types and is renegotiated on the policy anniversary date. It becomes progressively more expensive as the individual becomes older and may become non-renewable if the individual's health deteriorates and he does not have a guaranteed renewal clause in his policy. (See definitions of guaranteed renewal clause and permanent insurance.)
Testamentary trust:	A trust established by the will of a deceased individual. (See definition of trust.)
Testator:	The person who makes a will (testator - male; testatrix - female).
Trust:	An arrangement under which assets are set aside by an individual and administered by a trustee for the benefit of another person.
Undepreciated capital cost (UCC):	The undepreciated expenditures in respect of buildings, machinery and similar properties, calculated by asset class and written off on a reducing balance basis.
Vest indefeasibly:	A property "vests indefeasibly" if the person acquiring it obtains a right to absolute ownership in such a manner that the right cannot be taken away by any future event.
Wills Variation Act:	A statute in British Columbia that allows a court to vary the provisions of a will if it considers that the testator has not provided adequately for his spouse or children.

APPENDIX 2

TABLE OF INTESTATE SUCCESSION IN BRITISH COLUMBIA

If a Person Dies Intestate Leaving:	The Estate Will be Distributed as follows:
1. Spouse and no Issue	Whole Estate to Spouse
2. Spouse and one Child or Issue	First $65,000.00, All Household Furnishings, Matrimonial Home (life estate only) and 1/2 Residue to Spouse and 1/2 Residue to Child or Issue
3. Spouse and more than one Child or Issue	First $65,000.00, All Household Furnishings, Matrimonial Home (life estate only) and 1/3 Residue to Spouse and 2/3 Residue equally to Children and Issue
4. One or more Children or Issue but no Spouse	Whole Estate to Intestate's Children equally, Per Stirpes to Issue of a Deceased Child
5. Father and Mother but no Spouse or Issue	Whole Estate to Parents equally
6. Father but no Mother, Spouse or Issue	Whole Estate to Father
7. Mother but no Father, Spouse or Issue	Whole Estate to Mother
8. Siblings but no Spouse, Issue or Parent	Whole Estate to Siblings equally
9. Siblings and Children of Deceased Siblings but no Spouse, Issue or Parent	Whole Estate to Siblings equally, Per Stirpes to Children of Deceased Sibling
10. Children of Deceased Siblings but no Spouse, Issue, Parent or Sibling	Whole Estate equally to Nieces and Nephews alive at Intestate's death
11. No Spouse, Issue, Parent, Sibling or Child of Deceased Sibling	Whole Estate to next of kin of equal degree of blood relationship to Intestate alive at Intestate's death equally

Refer to the Glossary for the meaning of the terms "issue", "siblings", "life estate" and "per stirpes".

Prepared from information supplied by W.M.R. Newby of Baker, Newby & Company, Barristers & Solicitors

APPENDIX 3

ILLUSTRATION OF THE TAX DEFERRAL THAT CAN BE OBTAINED BY THE USE OF A CORPORATION

Assume that farm profits before payment to the farmer are $80,000 and that the farmer needs $40,000 to live on.

CORPORATION (assumes business carried on by corporation)

Farm profits		$ 80,000
Before-tax income required by farmer (paid from corporation as a salary)		40,000
"Excess" income retained in corporation		40,000
Corporate tax - 23%		9,200
Income retained and available for dividend	(A)	$ 30,800
Income retained and available for dividend		$ 30,800
Distribution tax (Note 4)		3,422
Net dividend to farmer		27,378
Tax on dividend - farmer (Notes 1 and 2)		5,397
Net to farmer from dividend	(B)	21,981
Net to farmer from $40,000 salary (Note 1)	(C)	27,419
Net to farmer in total	(D)	$ 49,400

INDIVIDUAL (assumes business carried on by individual)

Income		$ 80,000
Less tax (Note 1)		30,861
Net to farmer	(E)	$ 49,139

TAX DEFERRAL (assumes no dividend paid by company)

Income retained:

If corporation used:				
- retained by farmer from salary	(C)	27,419		
- retained by company	(A)	30,800		$ 58,219
If corporation not used:				
- retained by farmer			(E)	49,139
Tax deferral				$ 9,080

Illustration of the Tax Deferral that can be Obtained by the use of a Corporation

TAX SAVINGS (assumes dividend is paid by company)

Net to farmer:

If corporation used:	(D)	$ 49,400
If corporation not used:	(E)	49,139
Tax saving (Note 3)		$ 261

NOTES:

1. It is assumed that the farmer's exemptions are offset by his non-farming income, the federal marginal rates are those applying in 1986 and the provincial tax rate is 44%. The federal and provincial surtaxes have been ignored.

2. This is the tax that the farmer would pay on the dividend - assuming he had already received a $40,000 salary.

3. Theoretically, the distribution tax is supposed to remove all of this tax saving. A small saving remains, however, for a corporation in British Columbia, because of imperfections in the tax system.

4. Commencing January 1, 1987, the distribution tax was repealed. However, a compensating adjustment was made to the dividend tax credit so that, in total, the corporate and individual tax on farming income received through a corporation remains approximately the same.

It is important to remember that there will be a tax deferral only if the corporation generates more income than the farmer needs to live on and the excess is retained by the corporation. If all the income is flowed through to the farmer, he will be in approximately the same position as he would have been had he not used the corporation.

A farmer can perhaps increase the tax benefits arising from the use of a corporation by arranging for some of the shares to be held by his spouse or children. Income that would otherwise be taxed in his return as farm profits would then be taxed in his spouse's or children's returns as dividend income. The effect of this arrangement is that income is split between the farmer and other family members and the overall income tax liability is reduced.

APPENDIX 4

ILLUSTRATION OF THE POSSIBLE USE OF A CORPORATION IN DEALING WITH NON-FARM CHILDREN

Situation

Assume that a farmer who is about to retire has one son and 3 daughters and that his only significant asset is his farm which he would like to pass to his son. Assume that he is prepared to freeze his interest in the farm and to allow future increases in value to accrue to his son. Assume also that the farm has no debt.

The particulars of the farm are as follows:

	"Tax Basis"	Fair Market Value
Land - adjusted cost base	$ 150,000	
- fair market value		$ 500,000
Buildings, equipment		
- undepreciated capital cost	125,000	
- fair market value and original cost		300,000
Livestock, inventories		
- tax value	NIL	
- fair market value		155,000
Quota		
- 2 x cumulative eligible capital	100,000	
- fair market value		400,000
	$ 375,000	$ 1,355,000

Accrued untaxed gain $ 980,000

Plan

1. The farmer would establish a corporation with three different classes of shares.

Voting common shares

These would be the growth shares that would entitle the holder to one vote per share. Initially, they would have a nominal value but would increase in value as the farm grows. 100 of these shares would initially be issued to the farmer for $1 each and after a short holding period (say one or two months), would be gifted to his son. Structuring the transaction in this manner avoids potential sales tax problems.

Illustration of the Possible Use of a Corporation in Dealing with Non-farm Children

Voting preferred shares (Class A preferred)

These would be fixed-value shares through which the farmer would continue to exercise some "parental control" over the farm. Each share would entitle the farmer to one vote. He would acquire 300 of these shares at $1 each thus entitling him to 300 votes. Holding this number of votes would, if necessary, enable him to pass a special resolution authorizing the sale of the farm.

Non-voting preferred shares (Class B preferred)

These would be fixed-value, non-voting preferred shares that the farmer would receive in exchange for the farming assets to be transferred to the company. They would be redeemable on demand and would entitle him to a reasonable "non-cumulative" dividend. The "non-cumulative" feature means that if a dividend is not declared in a year, the right to receive that dividend is lost and is not carried forward to future years.

2. The farmer, his wife and his son would be appointed directors of the company.

3. The farming assets would be transferred to the company on a rollover basis using the rules in section 85 of the Income Tax Act. The sale would be made at fair market value and the consideration given by the company would be as follows:

Issue of debt for an amount equal to the farmer's "tax basis". This debt would be payable on demand and may entitle the farmer to a reasonable interest rate. (If the farmer had debts of, say, $200,000, they could be assumed by the company and the debt payable to the farmer would be reduced to $175,000.)	$ 375,000
Issue of non-voting Class B preferred shares with a value equal to the accrued gain on the farm	980,000
	$ 1,355,000

An income tax election would be filed with Revenue Canada.

4. As mentioned above, the Class B preferred shares would be redeemable on demand during the lifetime of the farmer (perhaps during the lifetime of his spouse as well - if she survives him and inherits the shares). After their death, the shares would be redeemable serially over a period of years. The period selected would depend on the

ability of the farm to generate the cash required to finance the redemption.

5. The debt and Class B preferred shares would represent the farmer's retirement capital. Debt repayments and interest on the debt would probably form the bulk of the farmer's retirement income. Additional income in the form of dividends on the Class B preferred shares would be received as required. The debt repayments would not be subject to tax as they would represent a return of the cost of the farmer's investment in the farming assets transferred to the corporation.

6. On the farmer's death, some or all of the Class B preferred shares and debt would pass to his spouse. She might acquire the Class A voting preferred shares as well.

   On her death, the Class A voting preferred shares would pass to the son and the Class B preferred shares would pass to all the children. The shares would transfer on a rollover basis provided the corporation qualified as family farm corporation.

7. Over the period following the death of the farmer and his wife, the Class B preferred shares held by the three daughters would be redeemed. Income tax would be payable on the redemption proceeds. Assuming the plan is well thought-out, the farm would generate sufficient income in this period to finance the redemption.

8. As a result of the recent introduction of the capital gains deduction, the plan might be varied as follows:

   - the land would be transferred at fair market value;

   - instead of receiving $375,000 in debt from the company, the farmer would receive $725,000. The additional $350,000 would represent the accrued capital gain on the land;

   - the value of the non-voting Class B preferred shares received from the company would be reduced by $350,000 to $630,000;

   - the farmer would have an additional $350,000 that could be withdrawn from the company on a tax-free basis.

   Before amending the plan in the manner described above the farmer would have to assess the impact of the minimum tax. Depending on the circumstances, it may be necessary for the farmer to elect to dispose of the land at a value between $150,000 and $500,000 in order to avoid the minimum tax.

9. The effect of the above would be as follows:
   - the farmer would be able to exercise some "parental control" during his lifetime and his retirement needs would be met;

Illustration of the Possible Use of a Corporation in Dealing with Non-farm Children

- the farmer's son would inherit the farm intact and would be able to run it without interference;
- the farmer's daughters would acquire an equitable interest in the farm and, ultimately, this inheritance will be received in cash;
- income tax on the accrued gain on the farm at the date of its incorporation would be deferred until the daughters began to redeem their shares;
- the share interests of the daughters would be redeemed using funds in the company that would not have been subject to tax at the shareholder level. This would minimize the funds that would have to be generated by the farm in order to finance the redemption.

The above is only an outline of a plan that might be satisfactory in certain situations. In a real-life situation, there would be many details that would have to be tailored to the farmer's particular circumstances. It is absolutely vital that this be done with the benefit of expert professional advice because there are many potential income tax problems. Depending on the circumstances, the adviser may wish to obtain an advance income tax ruling from Revenue Canada.

APPENDIX 5

ILLUSTRATION OF THE INCOME TAX RULES FOR THE CALCULATION OF RESERVES, WHERE PROPERTY IS SOLD AND PART OF THE SALES PROCEEDS REMAINS UNPAID

Assume

A farmer sells land to his son in January, 1986 for $480,000 and the total of his "adjusted cost base" (ACB) and the costs of disposition are $100,000.

The son makes a down payment of $120,000.

The balance owing of $360,000 ($480,000 - $120,000) is secured by a mortgage and is not repayable until the end of twelve years.

Calculations

Capital Gain		
Sale proceeds		$ 480,000
ACB plus costs of disposition		100,000
Capital gain before reserve		380,000
Reserve equals the lesser of:		
(a) $\frac{\text{Debt (\$360,000)}}{\text{Sale price (\$480,000)}}$ x gain ($380,000) =	$ 285,000	
And		
(b) $\frac{9}{10}$ x gain ($380,000) =	$ 342,000	
Lesser amount		285,000
Capital gain, after reserve		$ 95,000
Taxable capital gain (one-half), included in 1986 tax return		$ 47,500

In each of the nine years following the year of sale, the farmer would treat as a capital gain the reserve claimed at the end of the preceding year and would then claim a new reserve. The new reserve for any particular year would be based on the amount of debt not due at the end of that year but could not exceed 1/10th of the original capital gain ($380,000) times the number by which 9 exceeds the number of preceding taxation years ending after the disposition of the property. The effect of this rather complicated rule is that the reserve which is available to the farmer is gradually reduced to nil over the nine years following the year in which the sale is made. At the end of this period, the farmer will have paid all his tax liability even though he may not have received all of the proceeds from the sale of his farm.

In this illustration, the maximum reserve that could be claimed by the farmer at the end of each year and the taxable capital gain that would be included in his income each year is as follows:

Year After Sale	Closing Reserve	Capital Gain	Taxable Capital Gain
1	$ 285,000	$ NIL	$ NIL
2	266,000	19,000	9,500
3	228,000	38,000	19,000
4	190,000	38,000	19,000
5	152,000	38,000	19,000
6	114,000	38,000	19,000
7	76,000	38,000	19,000
8	38,000	38,000	19,000
9	NIL	38,000	19,000
		285,000	142,500
Amount calculated for year of sale (see above)		95,000	47,500
Total		$ 380,000	$ 190,000

APPENDIX 6

ILLUSTRATION OF THE CALCULATION OF THE ALTERNATIVE MINIMUM TAX

Assume

A farmer in B.C. sells his farm in 1986 and realizes the following income for income tax purposes:

Income from the sale of quota and livestock	$ 100,000
Recaptured depreciation on farm buildings and equipment	20,000
Taxable capital gain on sale of land and buildings (1/2 x $500,000)	250,000
Total income for tax purposes	$ 370,000

The farmer contributes $7,500 to his R.R.S.P. in 1986.

His exemptions and other deductions are offset by other miscellaneous income.

The combined federal/provincial alternative minimum tax rate is 25%.

Surtaxes can be ignored.

Calculation of the regular income tax liability

Income for tax purposes from the sale of the farm	$ 370,000
Less: Capital gains deduction	250,000
R.R.S.P. contribution	7,500
	257,500
Taxable income	$ 112,500
Regular tax thereon (approx)	$ 46,800

Illustration of the Calculation of the Alternative Minimum Tax

Calculation of the alternative minimum tax

Taxable income as determined above	$ 112,500
Add: Non-taxable half of capital gain	250,000
R.R.S.P. contribution	7,500
	370,000
Less basic exemption	40,000
Basis for minimum tax	$ 330,000
Minimum tax liability (25% x 330,000)	$ 82,500

Result

In this situation, the farmer would be required to pay the minimum tax of $82,500 because it is higher than the regular tax liability.

The excess of the minimum tax over the regular tax of $35,700 ($82,500 - $46,800) could be carried forward and deducted from the farmer's regular tax liability in the years 1987 to 1993 (7 years). If the carry-forward is not used in this period - it simply expires.

If the sale had occurred in the year in which the farmer died, the excess of the minimum tax could be carried back against his regular tax liability for the 3 years preceding the year of death (1983-85).

ESTATE PLAN INFORMATION

ADVISERS AND OTHER PERSONS

	Name	Tel.# and address
Accountant		
Bank		
Executors		
Insurance agent		
Solicitor		
Witnesses to will		
Others		

BUSINESS INFORMATION

Item	#	Location
Chequing accounts		
Safety deposit box		
Savings accounts		

(Update periodically)

Cut out and retain with records

ESTATE PLAN INFORMATION

ASSETS

REAL ESTATE		
Property address	% Owned	Location of Deeds

MORTGAGES AND AGREEMENTS RECEIVABLE			
Principal Amount	Property Address	Mortgagor/ Purchaser	Location of Documents

TERM DEPOSITS, SHARES, BONDS AND OTHER INVESTMENTS		
Principal Amount or # of Shares	Description of Investment	Location of Security

(Update periodically)

Cut out and retain with records

ESTATE PLAN INFORMATION

ASSETS (continued)

FARM MACHINERY, EQUIPMENT AND VEHICLES		
Item	Year, Make and Model	Location

(Update periodically)

Cut out and retain with records

ESTATE PLAN INFORMATION

ASSETS (continued)

FARM MACHINERY, EQUIPMENT AND VEHICLES		
Item	Year, Make and Model	Location

LIVESTOCK	
Number	Description

(Update periodically)

Cut out and retain with records

ESTATE PLAN INFORMATION

INSURANCE

INSURANCE POLICIES

Principal Amount	Insurance Company	Policy #	Location of Policy

LIABILITIES

MORTGAGES AND AGREEMENTS PAYABLE

Principal Amount	Property Address	Location of Documents

BANK LOANS

Principal Amount	Name and Address of Bank

INSURANCE POLICY LOANS

Principal Amount	Insurance Company	Policy #	Use of Funds

(Update periodically)

Cut out and retain with records

ESTATE PLAN INFORMATION

LEASED PROPERTY

Name and Address of Landlord	Address of Leased Property	Renewal Date

CREDIT CARDS

Company	Card #

SUPPLIERS WITH CHARGE ACCOUNTS

Name	Address

(Update periodically)

Cut out and retain with records

ESTATE PLAN INFORMATION

INSURANCE

INSURANCE POLICIES			
Principal Amount	Insurance Company	Policy #	Location of Policy

LIABILITIES

MORTGAGES AND AGREEMENTS PAYABLE		
Principal Amount	Property Address	Location of Documents

BANK LOANS	
Principal Amount	Name and Address of Bank

INSURANCE POLICY LOANS			
Principal Amount	Insurance Company	Policy #	Use of Funds

(Update periodically)

Cut out and retain with records

ESTATE PLAN INFORMATION

LEASED PROPERTY

Name and Address of Landlord	Address of Leased Property	Renewal Date

CREDIT CARDS

Company	Card #

SUPPLIERS WITH CHARGE ACCOUNTS

Name	Address

(Update periodically)

Cut out and retain with records

ESTATE PLAN INFORMATION

LOCATION OF WILL

Address	Person to Contact

DATE INFORMATION LAST UPDATED

____

____

____

____

____

____

____

____

(Update periodically)

Cut out and retain with records